

TAB 188

**In The Matter Of:**

*AHERF v.  
PRICEWATERHOUSECOOPERS, LLP.*

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*DOROTHY MCKENNA BROWN, ED.D.  
May 4, 2004*

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**BROWN, ED.D., DOROTHY MCKENNA**





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1 Dorothy McKenna Brown, Ed.D.  
 2 A. Management, yes.  
 3 Q. And did they refer to -- management refer to  
 4 this as an integrated delivery system or IDS?  
 5 A. I don't -- I'm not sure that I heard them say  
 6 that, but I would think that was the intention.  
 7 Q. And who in particular -- do you know whose  
 8 idea it was to develop AHERF into an integrated  
 9 system?  
 10 MR. McCLENAHAN: Object to form.  
 11 MS MEADEN: Objection.  
 12 A. I don't know whose idea it was, but Sherif  
 13 articulated the vision.  
 14 Q. And did the board of trustees agree with Mr.  
 15 Abdelhak's articulation of the need to develop an  
 16 integrated system for AHERF?  
 17 MS MEADEN: Objection.  
 18 A. We agreed with his vision.  
 19 Q. Do you remember any trustees -- just any  
 20 particular trustees voicing disagreement with the  
 21 vision, saying we should go another way instead?  
 22 A. No.  
 23 Q. Were there trustees who put questions to Mr.  
 24 Abdelhak about the vision that you recall?  
 25 MS MEADEN: Objection. Foundation.

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1 Dorothy McKenna Brown, Ed.D.  
 2 A. Well, the vision was in place before  
 3 Hahnemann merged, so when I arrived on the board,  
 4 they were playing out the vision I guess.  
 5 Q. Hahnemann acquisition was part of the vision?  
 6 A. Was part of the vision and so, you know, each  
 7 step along the way trustees would ask questions  
 8 and -- but there was no antagonism or great  
 9 disagreement with him.  
 10 Q. For subsequent acquisitions when you were on  
 11 the board after the Hahnemann acquisition, would Mr.  
 12 Abdelhak explain or present reasons why this  
 13 acquisition would make sense for AHERF and then they  
 14 would be approved by the board?  
 15 A. Usually.  
 16 Q. Are there any instances that come to mind  
 17 where that didn't happen?  
 18 A. Yes.  
 19 Q. And what was that or those?  
 20 A. Well, the Graduate Hospital acquisition. We  
 21 read about it in the papers. And when I called Mr.  
 22 Abdelhak, he said that it had been approved by the  
 23 executive committee, and a number of us complained  
 24 about such a large undertaking not being vetted with  
 25 the whole board before it was done.

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1 Dorothy McKenna Brown, Ed.D.  
 2 Q. Do you remember which newspaper you read  
 3 about that?  
 4 A. The Inquirer, Philadelphia Inquirer.  
 5 Q. That's the major daily newspaper here in  
 6 Philadelphia?  
 7 A. Yes.  
 8 Q. What was your -- well, do you remember  
 9 reading the article at home or in your office?  
 10 A. At home.  
 11 Q. And does the paper come out in the mornings?  
 12 A. Yes.  
 13 Q. And do you recall what the article said?  
 14 A. That Allegheny was -- I forget the word, and  
 15 it's probably -- it's an important distinction, but  
 16 that they were acquiring, I guess is the word, the  
 17 Graduate Health System.  
 18 Q. Let me show you a document that has  
 19 previously been marked as Exhibit 579.  
 20 MR. McCLENAHAN: Take a minute to read  
 21 it.  
 22 Q. Yes, please read this entire article. I will  
 23 tell you that Exhibit 579 is a copy of an article  
 24 that was printed off the Web site for the  
 25 Philadelphia Inquirer. It was an article that

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1 Dorothy McKenna Brown, Ed.D.  
 2 appeared on Page D-1 of the Philadelphia Inquirer on  
 3 August 11, 1996. This isn't the actual photocopy  
 4 from the newspaper, but when you go onto the Web  
 5 site, you can print the stories that were in the  
 6 newspaper. And I'll just give you time to read  
 7 this.  
 8 MS. MEADEN: Jeff, do you know whose  
 9 underlinings these are?  
 10 MR. FRIESEN: I don't know whose  
 11 underlinings they are. I know they're not mine.  
 12 Q. Oh, and, by the way, the headline of the  
 13 newspaper is "Absorbing Graduate Health Entails  
 14 Risk."  
 15 Do you think that this is the article --  
 16 A. Yes.  
 17 Q. -- that you were referring to?  
 18 And it looks like this was on the first  
 19 page of the business section?  
 20 MS. MEADEN: Objection.  
 21 MR. McCLENAHAN: Yeah, I mean --  
 22 A. Somewhere in there.  
 23 MR. McCLENAHAN: -- is that a question?  
 24 Q. Now, had you never heard of AHERF potentially  
 25 acquiring the Graduate Hospital System until you

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1 Dorothy McKenna Brown, Ed.D.  
 2 read this article?  
 3 A. Correct.  
 4 MS. MEADEN: Objection as to form.  
 5 Q. And down near the bottom it says "Allegheny  
 6 spokesman Tom Chakurda said this was expected to  
 7 last about a year before consolidation is complete."  
 8 Did you know who Mr. Chakurda was?  
 9 MR. McCLENAHAN: That is referring to  
 10 the paragraph immediately above it.  
 11 MR. FRIESEN: Yes. Let me back up.  
 12 Q. It says, "For now, Allegheny has agreed only  
 13 to manage the hospitals for an undisclosed fee  
 14 without taking full financial control or  
 15 responsibility for debt. Allegheny spokesman Tom  
 16 Chakurda said this was expected to last about a year  
 17 before consolidation is complete."  
 18 Did you know who Mr. Chakurda was?  
 19 A. I think he was the PR person.  
 20 Q. Do you see the first paragraph says, "The  
 21 Allegheny Health Education and Research Foundation  
 22 is about to take on a high-risk case in the Graduate  
 23 Health System according to the diagnosis of local  
 24 healthcare analysts"?  
 25 A. (Witness shakes head in the affirmative.)

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1 Dorothy McKenna Brown, Ed.D.  
 2 Q. Can you remember any reaction that you had  
 3 when you read that?  
 4 MS. MEADEN: Objection.  
 5 A. Should I answer?  
 6 MS. MEADEN: Go ahead.  
 7 Q. Oh, yes.  
 8 MR. McCLENAHAN: The question is do you  
 9 remember your reaction.  
 10 A. Yes, I do remember my reaction. As a  
 11 trustee, I didn't enjoy reading about a major change  
 12 in the newspaper, not knowing one thing about it,  
 13 and I called a variety of people -- I can't tell you  
 14 in what order, but the Philadelphia trustees, some  
 15 of them, Leslie Miller who was then chair of the  
 16 academic affairs committee, Claire Gargalli, Leon  
 17 Sunstein, Bob Palmer, Al Martinelli; and we had sort  
 18 of a back-and-forth conversation in different ways  
 19 about it.  
 20 I called Sherif and I asked him why he  
 21 had a board if he was going to have this kind of  
 22 activity without consulting with the full board, not  
 23 that I had a particular problem at that point with  
 24 the acquisition because it seemed to fit, as this  
 25 article goes on to relate, in with the vision, but

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1 Dorothy McKenna Brown, Ed.D.  
 2 boards are for comment in that kind of a situation I  
 3 think.  
 4 He told me that he had the approval of  
 5 the executive committee and he got quite annoyed and  
 6 hung up.  
 7 Q. He hung up on you?  
 8 A. He hung up on me, called the next morning at  
 9 5 o'clock to apologize.  
 10 And then we had a subsequent meeting,  
 11 and I'm sure you have the minutes and whatever where  
 12 he outlined the deal and how it would be handled and  
 13 it would not jeopardize the AHERF financial  
 14 stricture.  
 15 And the one thing that this doesn't say  
 16 but I think was said somewhere in a meeting, that  
 17 also coming with it would have been the money from  
 18 the Graduate Foundation, which I think was close to  
 19 a hundred million dollars, and it never did.  
 20 Q. It never did come?  
 21 A. It never did come, and I don't know that it  
 22 was part of the official deal, but I just have a  
 23 recollection of that in a conversation.  
 24 MS. MEADEN: I'm sorry. I don't mean to  
 25 interrupt, but just to clarify, a recollection that

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1 Dorothy McKenna Brown, Ed.D.  
 2 someone had told you that that money was going to  
 3 come --  
 4 THE WITNESS: That that foundation would  
 5 also come with...  
 6 Q. Okay. Let me try and unpack a few of these.  
 7 The conversations with Miss Miller, Miss  
 8 Gargalli, Mr. Sunstein, Mr. Palmer and  
 9 Mr. Martinelli, these were all separate  
 10 conversations?  
 11 A. Yes.  
 12 Q. There were no conference calls with more than  
 13 one of them on the line?  
 14 A. No.  
 15 And some of them wrote letters to  
 16 Sherif. I didn't. I called him. Some of them  
 17 called and wrote letters.  
 18 Q. And you called each of those people: Miller,  
 19 Gargalli, Sunstein, Palmer and Martinelli, before  
 20 you called Sherif?  
 21 MR. McCLENAHAN: If you know.  
 22 A. I don't remember. I probably called one or  
 23 two to say -- you know, because I thought was I  
 24 asleep at the switch or at some meeting and I didn't  
 25 hear this, and, you know, I can't tell you in what

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1 Dorothy McKenna Brown, Ed.D.  
 2 order I called, but none of those people had any  
 3 knowledge of it.  
 4 Q. Let me just plumb your memory for a moment on  
 5 each of these conversations. Maybe you don't  
 6 remember anything about them, but maybe you do.  
 7 Let's start with Leslie Ann Miller. Do  
 8 you remember any of the details of that  
 9 conversation?  
 10 A. No. As I remember it now -- I don't know how  
 11 many years we are going back -- they were pretty  
 12 much the same. There was just a general concern  
 13 that things of major importance were being  
 14 undertaken without discussing it with the full  
 15 board.  
 16 Q. And each of those people had that --  
 17 A. They had that same feeling.  
 18 Q. -- agreed with you?  
 19 A. You know, we didn't say, oh, it is going to  
 20 lose this much money or we are going to have to  
 21 spend or anything like that; it was really with  
 22 where the board fit in all of this activity.  
 23 Q. Can you remember anything specifically about  
 24 your conversation with Miss Gargalli other than what  
 25 you have already said?

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1 Dorothy McKenna Brown, Ed.D.  
 2 A. No.  
 3 Q. Mr. Sunstein?  
 4 A. No; with none of them.  
 5 I just remember Leslie Miller saying,  
 6 "I'm writing a letter this afternoon and it's going  
 7 right over there." That was...  
 8 Q. Did Mr. Abdelhak during your first  
 9 conversation with him -- by the way, do you think  
 10 your call to Mr. Abdelhak was on the same day that  
 11 you read the newspaper article?  
 12 A. I'm not certain, but very soon thereafter.  
 13 Q. Did he have any explanation for not coming to  
 14 the board with this prior to the article being  
 15 published other than that the executive committee  
 16 had approved it?  
 17 A. No. Just that the board would have an  
 18 opportunity to review all the details at its  
 19 subsequent meeting and so on and so forth.  
 20 Q. And did that satisfy you at the time?  
 21 A. Well, not really. I mean, I just -- it was  
 22 done, and so I was not aware that it had ever  
 23 happened before and I'm not aware that it ever  
 24 happened after that.  
 25 Q. I'm sorry. What do you mean "it was done"?

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1 Dorothy McKenna Brown, Ed.D.  
 2 A. The conversation and whatever had taken  
 3 place, and, you know, couldn't take it back.  
 4 Q. I see. His interview with the press --  
 5 A. Or whoever.  
 6 Q. -- Mr. Jacordis?  
 7 A. The other thing that I have learned is that  
 8 when these things are reported, when anything is  
 9 reported, it's probably half true and half wishful  
 10 thinking, so, you know, how far along were they  
 11 really compared to what this article says, that's  
 12 questionable.  
 13 Q. I take it people don't hang up on you very  
 14 often?  
 15 A. I never had anyone hang up on me before  
 16 except my mother.  
 17 MR. McCLENAHAN: That's allowed.  
 18 Q. Do you remember where you were in the  
 19 conversation when he hung up on you?  
 20 A. I said to him, "I don't know why you have a  
 21 board if you are going to operate like this," and  
 22 that's when he hung up.  
 23 Q. Now, the next morning when he called to  
 24 apologize, what do you remember about that  
 25 conversation?

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1 Dorothy McKenna Brown, Ed.D.  
 2 A. I remember I was half asleep, but --  
 3 Q. He called you at home at 5:00 a.m.?  
 4 A. 5:00, 5:30, something like that. And he just  
 5 said he was sorry for any misunderstanding, that he  
 6 thought he had operated according to the guidelines  
 7 and the bylaws and so on and so forth. And I said  
 8 "Well, fine." I appreciated his call and we let it  
 9 be.  
 10 Q. Did any of the other folks, Miller, Gargalli,  
 11 Sunstein, Palmer or Martinelli, talk to you  
 12 subsequently about any conversations that they had  
 13 with Mr. Abdelhak about this subject?  
 14 A. No. I know some of them said they called,  
 15 but they didn't talk about the details of the  
 16 conversation that I remember.  
 17 Q. Did any of your friends or any other  
 18 colleagues in Philadelphia tell you that they read  
 19 the article and they knew you were on the board?  
 20 A. No, I don't remember.  
 21 Q. Now, did you ultimately attend the meeting  
 22 where the acquisition of Graduate Hospital System  
 23 was approved?  
 24 A. Yes.  
 25 MS. MEADEN: Objection.





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1 Dorothy McKenna Brown, Ed.D.  
 2 A. No.  
 3 Q. Now, if Coopers & Lybrand had brought such  
 4 matters to the attention of the audit committee,  
 5 would it -- would you have expected the audit  
 6 committee to conduct an investigation into those  
 7 issues raised by Coopers?  
 8 MR. FRIESEN: Objection.  
 9 A. Yes.  
 10 Q. And is it your belief that the committee  
 11 would have conducted a thorough investigation of  
 12 such matters?  
 13 MR. FRIESEN: Objection.  
 14 A. Yes.  
 15 Q. And based on some of your testimony earlier  
 16 today, I sensed that you were never hesitant, if  
 17 issues were presented to you that you were concerned  
 18 about, to inquire further and get answers to the  
 19 questions you had, correct?  
 20 MR. FRIESEN: Objection.  
 21 A. Yes.  
 22 Q. That's a fair statement?  
 23 A. Yes. Why wouldn't I?  
 24 Q. Right, right.  
 25 So if you had ever heard that these

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1 Dorothy McKenna Brown, Ed.D.  
 2 issues that I listed earlier had been raised by  
 3 AHERF's outside auditors and that came to your  
 4 attention, do you believe that you would have either  
 5 conducted an investigation on your own or gone to  
 6 people to insist that they conduct -- the  
 7 appropriate people to insist they conduct such an  
 8 investigation?  
 9 MR. FRIESEN: Objection. Calls for  
 10 speculation.  
 11 A. Yes; not on my own, but I would have gone to  
 12 people that I thought were qualified to do such a  
 13 thing.  
 14 Q. And that would have been members of the audit  
 15 committee?  
 16 A. Right, or the resources.  
 17 Q. Resource management committee, is that what  
 18 you meant?  
 19 A. Committee. I keep calling it a finance  
 20 committee in my head, but it was resources.  
 21 Q. But that's what you were talking about?  
 22 A. Yeah.  
 23 Q. And you certainly would have wanted to know  
 24 what the results of that investigation were had one  
 25 been conducted, correct?

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1 Dorothy McKenna Brown, Ed.D.  
 2 MR. FRIESEN: Objection.  
 3 A. Yes.  
 4 Sorry.  
 5 Q. Do you have any reason to believe that if  
 6 Coopers & Lybrand had ever raised any of these  
 7 issues with the audit committee at AHERF that the  
 8 audit committee would not have conducted any  
 9 investigation into those allegations?  
 10 MR. FRIESEN: Objection.  
 11 A. No.  
 12 Q. If the audit committee had heard such  
 13 allegations from Coopers & Lybrand and had conducted  
 14 such an investigation, it would have been your  
 15 expectation that they would then follow whatever  
 16 prudent course seemed dictated by the results of  
 17 that investigation, correct?  
 18 MR. FRIESEN: Objection.  
 19 A. Yes.  
 20 Q. And if at the end of such an investigation  
 21 the audit committee had come to the board and made a  
 22 recommendation to the board about a course of action  
 23 to follow and had sufficiently satisfied any  
 24 questions that you may have had, would you believe  
 25 that you would have followed the recommendation of

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1 Dorothy McKenna Brown, Ed.D.  
 2 the audit committee in that regard?  
 3 MR. FRIESEN: Objection.  
 4 A. Yes.  
 5 Q. Yes, you would have?  
 6 A. I would, yeah.  
 7 Q. Prior to the fall of 1998, did you ever have  
 8 any question as to the accuracy of AHERF's financial  
 9 statements?  
 10 A. No.  
 11 Q. Did you have any --  
 12 MR. FRIESEN: I'm sorry. Did you say  
 13 fall of 1998?  
 14 MS. MEADEN: Yes.  
 15 MR. FRIESEN: Objection.  
 16 Mischaracterizes the prior testimony.  
 17 MS. MEADEN: I didn't characterize her  
 18 testimony. I asked her a question if she had any.  
 19 MR. FRIESEN: Okay. Contradicts prior  
 20 testimony.  
 21 MS. MEADEN: I don't think it does, but  
 22 all right.  
 23 THE WITNESS: I don't think it does.  
 24 MR. McCLENAHAN: Let's just go to the  
 25 next question. We can have this debate later on.



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1 Dorothy McKenna Brown, Ed.D.  
 2 Q. Did you make any observations as to -- strike  
 3 that.  
 4 Did you come to understand at some point  
 5 that Mr. McConnell had been terminated, his  
 6 employment had been terminated at AHERF?  
 7 A. Yes.  
 8 Q. Did you have any understanding as to why his  
 9 employment was terminated?  
 10 A. No.  
 11 Q. Were you involved in the decision to  
 12 terminate his employment?  
 13 A. No.  
 14 Q. Do you recall during the summer and fall of  
 15 1998, late summer, early fall of 1998, there was  
 16 some question as to whether AHERF's 1997 audited  
 17 financial statements could continue to be relied  
 18 upon?  
 19 A. Yes.  
 20 Q. Tell me how you first learned of that.  
 21 A. I'm not sure. I may have read it in the  
 22 newspaper.  
 23 Q. Do you recall why it was that there was some  
 24 concern as to whether those financial statements  
 25 could continue to be relied upon?

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1 Dorothy McKenna Brown, Ed.D.  
 2 A. No.  
 3 Q. Do you recall that there was a public  
 4 announcement made, I think in September of 1998,  
 5 that those statements should no longer be relied  
 6 upon, the audited financial statements of AHERF for  
 7 fiscal year 1997?  
 8 A. It's a bit of a blur, but I'm sure that I  
 9 knew it when it was announced.  
 10 Q. Were you involved at all in the decision to  
 11 make that public announcement?  
 12 A. No.  
 13 Q. At some point in time did you come to  
 14 question the thoroughness or the competency of  
 15 Coopers & Lybrand's audit of AHERF's financial  
 16 statements?  
 17 MR. FRIESEN: Objection.  
 18 A. Only after that announcement that they had to  
 19 recast them or --  
 20 Q. Do you recall specifically --  
 21 A. That would be in that September time frame.  
 22 Q. Do you recall having any discussions with  
 23 anyone on the AHERF board or within AHERF management  
 24 about that issue?  
 25 A. No.

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1 Dorothy McKenna Brown, Ed.D.  
 2 Q. During that same time period a decision was  
 3 made not to continue to retain  
 4 Pricewaterhousecoopers, which was the successor to  
 5 Coopers & Lybrand?  
 6 A. Right.  
 7 Q. Are you familiar with that decision?  
 8 A. Yes.  
 9 Q. Were you involved in that decision?  
 10 A. No.  
 11 Q. Did you have any understanding as to why that  
 12 decision was made?  
 13 A. I guess because there was a lack of  
 14 satisfaction with the previous audit.  
 15 Q. Did you have any conversations with anyone  
 16 about that --  
 17 A. No.  
 18 Q. -- topic?  
 19 At one point earlier today we were  
 20 looking at Book 3 for a board meeting of 12/16/1994,  
 21 and we don't need to refer to that, but I'm just  
 22 trying to put in context your testimony. And I  
 23 think Mr. Friesen was asking you questions about the  
 24 physician practice acquisition, and I think your  
 25 testimony was that you raised a question at that

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1 Dorothy McKenna Brown, Ed.D.  
 2 point, do we have enough money to do all of these  
 3 things?  
 4 A. Or sometime prior. In that time frame. I  
 5 don't know if it was at that hearing or not.  
 6 Q. And I think you said that someone answered  
 7 with a definitive yes?  
 8 A. I think it was Sherif.  
 9 Q. That was my question. Do you recall who?  
 10 A. Yes, I think it was Sherif, and I think he  
 11 said we have plenty of money.  
 12 Q. And do you recall until the fall of 1997 Mr.  
 13 Abdelhak giving recurrent assurances to the board  
 14 that the system was financially strong enough to  
 15 absorb acquisitions of hospitals and acquisitions of  
 16 physician practices?  
 17 A. I can't quote him the way I did in that  
 18 particular instance, but, yes, I have a sense that  
 19 we were regularly assured that while there was a lot  
 20 of work to be done, it could be done.  
 21 Q. And, to be clear, you never heard from the  
 22 outside auditors --  
 23 A. No.  
 24 Q. -- that Mr. Abdelhak's assurances in that  
 25 regard were incorrect or inaccurate, correct?

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1 Dorothy McKenna Brown, Ed.D.  
 2 A. No.  
 3 MR. FRIESEN: Objection.  
 4 Q. Earlier this afternoon Mr. Friesen also  
 5 showed you the 1996 audited financial statements,  
 6 and, again, there is no need to go back and look at  
 7 them. I'm just trying to put in context your  
 8 testimony. And he asked you if you reviewed the  
 9 financial statements as a practice when you got  
 10 them. And I believe your testimony was you  
 11 typically looked at the letter from the auditors and  
 12 the balance sheet and then perhaps looked at  
 13 footnotes if something caught your interest,  
 14 correct?  
 15 A. Yes.  
 16 Q. And I think you said you expected highly  
 17 unusual items to be pointed out by the finance  
 18 committee?  
 19 A. Or the audit committee.  
 20 Q. Or the audit committee?  
 21 A. Or the audit committee.  
 22 Q. And did you in that same vein expect highly  
 23 unusual items to be pointed out by the outside  
 24 auditors?  
 25 A. I would assume they would have been

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1 Dorothy McKenna Brown, Ed.D.  
 2 pointed -- would have been pointed out to the audit  
 3 committee.  
 4 Q. By the outside auditors?  
 5 A. By the outside auditors.  
 6 Q. And, again, you are not aware of Coopers &  
 7 Lybrand ever pointing --  
 8 A. No.  
 9 Q. -- out such highly unusual items to the audit  
 10 committee, correct?  
 11 A. No.  
 12 MR. FRIESEN: Objection.  
 13 MS. MEADEN: Thank you for your  
 14 patience, Dr. Brown. I don't have any further  
 15 questions at this point. Mr. Friesen may.  
 16 BY MR. FRIESEN:  
 17 Q. I just have a few.  
 18 I would like to clarify one thing, Dr.  
 19 Brown. In response to Miss Meaden's question, you  
 20 testified that prior to the fall of 1998 you  
 21 didn't -- I think you said you didn't believe that  
 22 any of AHERF's financial statements were inaccurate?  
 23 A. No, I think she asked if Coopers' financial  
 24 statements were inaccurate.  
 25 MS. MEADEN: The audited.

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1 Dorothy McKenna Brown, Ed.D.  
 2 A. The audited.  
 3 Q. Well, what she said was financial statements,  
 4 and I want to be clear what we are talking about  
 5 here.  
 6 A. Okay.  
 7 Q. Did you mean in your answer to talk about  
 8 audited financial statements?  
 9 A. I meant audited financial statements. As I  
 10 indicated earlier, I had great concern when Sherif  
 11 said, quote, I don't have good numbers.  
 12 Q. That's what I was getting at, and that was  
 13 the source of my confusion.  
 14 The second question I have is with  
 15 respect to the timing of the Graduate acquisition.  
 16 The testimony that you gave about believing that  
 17 there was a period of time within which the Graduate  
 18 entities could be given back to prior management, I  
 19 think you testified in response to Miss Meaden's  
 20 questions that that was during the due diligence or  
 21 trial period?  
 22 A. Yes.  
 23 Q. Now, did you approve of the acquisition  
 24 beyond the trial period, or did you think that  
 25 beyond the trial period you would have to approve it

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1 Dorothy McKenna Brown, Ed.D.  
 2 again?  
 3 A. Well --  
 4 MS. MEADEN: Objection. Vague.  
 5 Compound.  
 6 Go ahead.  
 7 A. I think there is a -- something you showed me  
 8 here --  
 9 Q. Right.  
 10 A. -- minutes that talk about the final  
 11 presentation by Sherif, if I'm not mistaken.  
 12 Q. Exhibit 832, which are the minutes of the  
 13 December 12, 1996.  
 14 A. Yes.  
 15 Q. Beginning on Page 743. That's right. Thank  
 16 you.  
 17 The paragraph on 743, the introduction  
 18 there says, "The president," meaning Mr. Abdelhak,  
 19 "reviewed the overall plans underway and steps taken  
 20 to date to accomplish the integration and  
 21 transaction of appropriate GHS activities to AHERF,  
 22 noting that final form of the reorganization will be  
 23 determined as current due diligence reviews and  
 24 other financial legal and operational analyses are  
 25 completed."

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1 Dorothy McKenna Brown, Ed.D.  
 2 A. Yes.  
 3 Q. And then the resolution goes on.  
 4 A. For pages.  
 5 Q. Yes.  
 6 And my question -- and I can point you  
 7 to specific paragraphs of the resolution if you  
 8 like, but before I do that, my question is: Did you  
 9 understand that this resolution gave Mr. Abdelhak  
 10 the authority to finally fold the Graduate entities  
 11 into the AHERF system once due diligence was  
 12 complete? And if you like, I can point to specific  
 13 paragraphs.  
 14 MR. McCLENAHAN: If you have a current  
 15 recollection what this all meant in December of  
 16 1996 --  
 17 THE WITNESS: I don't have a current  
 18 recollection.  
 19 MR. FRIESEN: Well, it may help to look  
 20 at --  
 21 MR. McCLENAHAN: Let me finish.  
 22 -- then you can answer that question.  
 23 But unless you have such a current recollection or  
 24 unless counsel can specifically refresh your memory,  
 25 you shouldn't speculate on what these pages of

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1 Dorothy McKenna Brown, Ed.D.  
 2 resolutions mean or say.  
 3 A. I don't have a current recollection.  
 4 Q. Let me try to refresh your recollection then.  
 5 If you go to Page 745, the middle  
 6 paragraph says --  
 7 MR. McCLENAHAN: Why don't you start at  
 8 the top of that page if we are going to be referring  
 9 to it.  
 10 Q. The middle paragraph says, "Whereas, although  
 11 due diligence reviews are continuing, AHERF  
 12 management has concluded that certain of the  
 13 operations and assets of the GHS subsidiaries should  
 14 be integrated into the AHERF system including,  
 15 without limitation, three of the adult community  
 16 hospitals (the Graduate Hospital, City Avenue  
 17 Hospital and Rancocas Hospital), the physician  
 18 satellite network, and the Bermuda offshore captive  
 19 insurance company, GHS Re, Inc."  
 20 And if you could read to yourself the  
 21 paragraphs on Page 746.  
 22 MR. McCLENAHAN: Is there a question?  
 23 MR. FRIESEN: Yes.  
 24 Q. The question is: Did you think at the time  
 25 during this meeting that you were approving simply a

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1 Dorothy McKenna Brown, Ed.D.  
 2 trial period wherein there would be due diligence  
 3 and AHERF would manage the Graduate entities for a  
 4 period of time, or did you think that you were  
 5 approving the ultimate acquisition if due diligence  
 6 turned out to be satisfactory?  
 7 MS. MEADEN: Objection.  
 8 MR. McCLENAHAN: Are you finished?  
 9 MR. FRIESEN: Yes.  
 10 MR. McCLENAHAN: Objection. That  
 11 question is if you have a recollection.  
 12 A. I truly don't remember. If I voted for it, I  
 13 voted for it and I had read the material ahead of  
 14 time, but I don't remember.  
 15 Q. Even apart from this document, since you  
 16 yourself have testified about this trial period, do  
 17 you recall believing when you approved the trial  
 18 period that management would have to come back to  
 19 the board for the final --  
 20 A. Yes.  
 21 Q. -- approval?  
 22 A. Yes.  
 23 Q. And do you recall that ever happening?  
 24 A. No.  
 25 Q. But you recall at some point that Graduate

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1 Dorothy McKenna Brown, Ed.D.  
 2 was actually folded into AHERF?  
 3 A. Yes.  
 4 Q. And when you found out about that, did you  
 5 tell anyone that this should have been brought back  
 6 to the board again?  
 7 MS. MEADEN: Objection.  
 8 A. No.  
 9 MR. FRIESEN: I don't have any further  
 10 questions.  
 11 BY MS. MEADEN:  
 12 Q. I have a couple of followup questions.  
 13 When Mr. Abdelhak said in that meeting  
 14 in I think the May time period of 1998 that he  
 15 didn't have good numbers, was he specifically  
 16 referring to internal financial statements, or was  
 17 he looking at internal financial statements?  
 18 A. I think that's what he was talking about  
 19 because the three more astute financial members on  
 20 that committee were asking him specific questions  
 21 about cash flow and a new word that I learned EB --  
 22 MR. McCLENAHAN: EBITDA.  
 23 Q. EBITDA.  
 24 A. -- EBITDA, and I had to go home and look that  
 25 one up, and things like that. And after some

TAB 189

**In The Matter Of:**

*AHERF v.  
PRICEWATERHOUSE COOPERS, LLP.*

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*DONALD KAY, M.D.  
June 18, 2003*

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**KAY, M.D., DONALD**



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DONALD KAYE, M.D.,

| Page 374  | Page 376   |
|---|--|
| <p>1 acquisition.</p> <p>2 BY MR. McDONOUGH:</p> <p>3 Q. Now, Dr. Kaye, even including the</p> <p>4 benefits obtained as a result of the</p> <p>5 efforts that you described, just</p> <p>6 described, is it correct that AIHG</p> <p>7 nonetheless continued to lose a very</p> <p>8 substantial amount of money?</p> <p>9 A. Yes, it is. And a lot of the</p> <p>10 reasons were that the critical mass, the</p> <p>11 practices, had already been acquired and</p> <p>12 others were coming on line that had been</p> <p>13 already either purchased or fairly</p> <p>14 binding agreements had been made. And</p> <p>15 so, with the new practices, there were</p> <p>16 more total losses.</p> <p>17 Q. And so the reasons for those</p> <p>18 losses, as I understand your answer, is</p> <p>19 that much of what was in AIHG was</p> <p>20 already there and already the basis of</p> <p>21 agreements at the time you arrived.</p> <p>22 A. That is correct. And there were</p> <p>23 others that were committed to, which</p> <p>24 then came on line and added to the</p> <p>25 losses.</p> | <p>1 president, do you recall any discussion</p> <p>2 or reference to the fact of an</p> <p>3 acquisition phase and then a</p> <p>4 consolidation phase?</p> <p>5 A. No. But the termination or</p> <p>6 slowing down of the acquisition phase is</p> <p>7 clearly a reference to my intent and</p> <p>8 efforts to slow it down.</p> <p>9 Q. How about the referenced term</p> <p>10 here, "consolidation integration phase";</p> <p>11 is that something that means anything to</p> <p>12 you?</p> <p>13 A. No. That's his terminology.</p> <p>14 This -- these were never formally</p> <p>15 approved terms of anything, but I -- the</p> <p>16 concept is that he is referring to a</p> <p>17 need for consolidation, integration,</p> <p>18 improvement, which I certainly can't</p> <p>19 disagree with.</p> <p>20 Q. And in fact, is the process of</p> <p>21 trying to take what you had at AIHG and</p> <p>22 make it work in a more consolidated and</p> <p>23 integrated fashion something you paid</p> <p>24 attention to as well?</p> <p>25 A. Work better. I don't know really</p> |
| Page 375  | Page 377   |
| <p>1 MR. McDONOUGH: Mark this as</p> <p>2 the next number, please.</p> <p>3 MR. KRUSKO: It's 1514.</p> <p>4 (Exhibit 1514 was marked for</p> <p>5 identification.)</p> <p>6 BY MR. McDONOUGH:</p> <p>7 Q. Dr. Kaye, I'm going to show you</p> <p>8 what's been marked as Exhibit 1514. It</p> <p>9 is, first of all, a fax cover page</p> <p>10 indicating a delivery to you dated</p> <p>11 October 1st of 1997, and attached to it</p> <p>12 is something titled the AIHG Policy and</p> <p>13 Performance.</p> <p>14 Do you see that?</p> <p>15 A. Yes.</p> <p>16 Q. I'd like you to turn to the last</p> <p>17 page of that exhibit. And in the last</p> <p>18 paragraph, there is a sentence that</p> <p>19 reads, In summary, our acquisition phase</p> <p>20 is complete and our consolidation</p> <p>21 integration phase is to begin.</p> <p>22 Do you see that?</p> <p>23 A. Yes.</p> <p>24 Q. Dr. Kaye, at any point when you</p> <p>25 were involved with AIHG as its</p>   | <p>1 what's being consolidated or what's</p> <p>2 being integrated. I'm -- my concern was</p> <p>3 in terms of making it work better, and</p> <p>4 that included disease management, more</p> <p>5 medical direction, more oversight.</p> <p>6 Q. You can put that to the side.</p> <p>7 Thank you.</p> <p>8 Dr. Kaye, do you recall being</p> <p>9 part of any discussions concerning a</p> <p>10 proposed acquisition or a possible</p> <p>11 acquisition of the Graduate Hospital</p> <p>12 System?</p> <p>13 A. Yes. I was certainly present when</p> <p>14 various discussions were held about the</p> <p>15 Graduate System.</p> <p>16 Q. Okay. Well, my specific</p> <p>17 reference, though, was to not any part</p> <p>18 of the acquisition. I'm talking about</p> <p>19 discussions about whether there should</p> <p>20 be an acquisition of the Graduate</p> <p>21 Hospital System.</p> <p>22 A. Yes. Again, there were multiple</p> <p>23 such discussions along the line.</p> <p>24 Q. And with whom were those</p> <p>25 discussions held?</p>                                   |



DONALD KAYE, M.D.,

| Page 378  | Page 380  |
|---|---|
| <p>1 A. Primarily with Mr. Abdelhak. But<br/>2 also, the various stages and<br/>3 possibilities were discussed at a board<br/>4 level. As a matter of fact, I can't<br/>5 swear to this but I'm pretty sure that<br/>6 the first I heard about the possibility<br/>7 of a Graduate acquisition was at a board<br/>8 meeting.<br/>9 Q. And taking first the discussions<br/>10 with Mr. Abdelhak, can you recall for me<br/>11 what was discussed as the pros and cons,<br/>12 pros or cons of proceeding with the<br/>13 Graduate Hospital Acquisition?<br/>14 A. Yes. I was asked my opinion. I<br/>15 had the feeling that the basic decision<br/>16 had already been made and, therefore,<br/>17 what I did was gave the pros and the<br/>18 cons as I saw them as opposed to saying<br/>19 yes or no, which I didn't feel would<br/>20 have been very helpful; as with the<br/>21 Hahnemann acquisition, I gave what I<br/>22 felt were the pros and cons.<br/>23 I didn't come out for it, for<br/>24 sure, and certainly didn't veto it<br/>25 because I felt it would not have been a</p>  | <p>1 hospitals which were very poorly-<br/>2 thought-of, such as the City Line Avenue<br/>3 Hospital, Parkview Hospital, and Sinai,<br/>4 which I saw no future for and I felt<br/>5 basically it should be closed, with the<br/>6 activity moved to our existing hospitals<br/>7 should the acquisition go forward.<br/>8 One other pro would be that<br/>9 Graduate Hospital was in a part of the<br/>10 city where we didn't have anything at<br/>11 the time. So those were the pros and<br/>12 the cons.<br/>13 Q. At the time the potential<br/>14 acquisition was discussed with<br/>15 Mr. Abdelhak, was it your understanding<br/>16 that the Graduate system was losing<br/>17 money?<br/>18 A. At -- we had these discussions at<br/>19 various points in time. I don't think<br/>20 there was one day where we sat down and<br/>21 discussed everything about it, because<br/>22 we had discussions and then there was<br/>23 due diligence being done.<br/>24 My understanding is that some<br/>25 of the components were losing money and</p>               |
| Page 379  | Page 381  |
| <p>1 useful thing to do because it was going<br/>2 to happen anyway.<br/>3 Q. And as best you can recollect,<br/>4 what was the basis for your conclusion<br/>5 that it was going to happen anyway?<br/>6 A. My feelings and my knowledge of<br/>7 Mr. Abdelhak.<br/>8 Q. What were the pros and cons that<br/>9 you recall discussing with Mr. Abdelhak?<br/>10 A. As I saw them, the pros were that<br/>11 there was Graduate Hospital, which was a<br/>12 highly-thought-of hospital with a<br/>13 highly-thought-of staff in Philadelphia,<br/>14 that they had a practice organization<br/>15 which was much more efficient than<br/>16 the -- than AIHG. I believe they had --<br/>17 whether they had taken more care in<br/>18 selecting or whether their contracts<br/>19 were different or whatever, they were<br/>20 not losing large amounts of money.<br/>21 The cons I felt were Graduate<br/>22 Hospital, which was a tertiary care<br/>23 hospital, which would be competing with<br/>24 Hahnemann and MCP, both of which were<br/>25 tertiary care hospitals; some very weak</p> | <p>1 some of the components were making money<br/>2 but that, as a whole, they weren't<br/>3 doing -- as a whole, they were not<br/>4 making money. But the thought was that<br/>5 by efficiencies of management, by<br/>6 downsizing their finance department,<br/>7 personnel, all of the other support<br/>8 areas, by extending hours, that there<br/>9 would be efficiencies in the<br/>10 consolidation.<br/>11 I was not clearly in favor of<br/>12 the acquisition but I clearly did not<br/>13 veto it because I would -- really wasn't<br/>14 in a position to veto it.<br/>15 Q. And I take it from that answer,<br/>16 Dr. Kaye, that shifting to the<br/>17 discussion of the Graduate acquisition<br/>18 at the board level, you did not speak<br/>19 against the possibility.<br/>20 A. No. At the board meeting -- the<br/>21 AHERF board meeting anyway, where this<br/>22 would have been primarily discussed --<br/>23 it was a question of doing due diligence<br/>24 and looking into it and making a<br/>25 determination at a later time as to</p> |

DONALD KAYE, M.D. ,

| Page 382  | Page 384  |
|---|---|
| <p>1 whether or not it would be taken into</p> <p>2 AHERF, as the expression goes.</p> <p>3 Q. To your -- based on your</p> <p>4 knowledge, Dr. Kaye, did any member of</p> <p>5 the AHERF board, at the meeting you</p> <p>6 reference or any other time in your</p> <p>7 presence, vote or argue against the</p> <p>8 Graduate acquisition?</p> <p>9 A. I believe there was general</p> <p>10 skepticism from many of the board</p> <p>11 members. I don't specifically recall</p> <p>12 any arguments or vetos, but I do recall</p> <p>13 a general concern and skepticism about</p> <p>14 the Graduate system.</p> <p>15 Q. Do you recall that any board</p> <p>16 member voted against the concept of</p> <p>17 acquisition?</p> <p>18 A. No, I don't really actually recall</p> <p>19 a vote, per se, although I'm certain one</p> <p>20 must have been taken.</p> <p>21 Q. Dr. Kaye, I'll show you what's</p> <p>22 been marked as, previously marked as</p> <p>23 Deposition Exhibit 751. It is a copy of</p> <p>24 a news release dated August 6th of 1996.</p> <p>25 Do you see that?</p> | <p>1 was that SDN was the organization used</p> <p>2 to acquire the United Hospitals, to</p> <p>3 manage the United Hospitals while due</p> <p>4 diligence was being done, and then to</p> <p>5 transfer the hospitals or other assets</p> <p>6 that were to be incorporated into</p> <p>7 AHERF -- to AHERF, and then to sell,</p> <p>8 close or discontinue other operations</p> <p>9 that were part of the United Hospital</p> <p>10 operations.</p> <p>11 Specifically, I recall that</p> <p>12 there was an ambulance company and there</p> <p>13 were several other companies that were</p> <p>14 either sold or discontinued by SDN.</p> <p>15 Q. Is it your recollection, Dr. Kaye,</p> <p>16 that the AHERF board was aware that SDN</p> <p>17 would be the initial vehicle utilized by</p> <p>18 AHERF for acquisition of the Graduate</p> <p>19 Health System?</p> <p>20 MR. WHITNEY: Objection to</p> <p>21 form and foundation</p> <p>22 THE WITNESS: Of the Graduate</p> <p>23 Health System? Did I realize that --</p> <p>24 I know that AHERF was aware</p> <p>25 of SDN, and I know that the AHERF board</p> |
| Page 383  | Page 385  |
| <p>1 A. Yes, I do.</p> <p>2 Q. And to put this in perspective,</p> <p>3 Dr. Kaye, would that have been in the</p> <p>4 first quarter of fiscal 1997 for the</p> <p>5 AHERF eastern hospitals?</p> <p>6 A. Yes, it would have been.</p> <p>7 Q. Now, Dr. Kaye, does this assist in</p> <p>8 refreshing your recollection that the</p> <p>9 initial announcement of the Graduate</p> <p>10 Health System occurred during the summer</p> <p>11 of 1996 or during the early part of the</p> <p>12 fiscal 1997 year?</p> <p>13 A. Yes. I know the initial</p> <p>14 discussions or planning occurred about</p> <p>15 that time. I am not specifically</p> <p>16 familiar with this release.</p> <p>17 Q. This release, Dr. Kaye,</p> <p>18 indicates -- this press release</p> <p>19 indicates that the transfer will be</p> <p>20 accomplished by transferring</p> <p>21 subsidiaries of GHS, that's the Graduate</p> <p>22 Health System, to a membership in SDN.</p> <p>23 What was SDN?</p> <p>24 A. My best understanding of SDN, the</p> <p>25 first contact I had in any way with SDN,</p>        | <p>1 was told that these hospitals would be</p> <p>2 under the management of SDN while due</p> <p>3 diligence was being done, and I know</p> <p>4 that the AHERF board was told that they</p> <p>5 would be appraised before -- or,</p> <p>6 apprised of any further steps and would</p> <p>7 have to agree to incorporate whatever</p> <p>8 hospitals of the Graduate system were to</p> <p>9 be incorporated at a later date.</p> <p>10 BY MR. McDONOUGH:</p> <p>11 Q. Now, Dr. Kaye, is it your</p> <p>12 recollection that due diligence or</p> <p>13 financial analysis of the Graduate</p> <p>14 Health System was, in fact, done by the</p> <p>15 AHERF system?</p> <p>16 A. It was done by the AHERF finance</p> <p>17 department. Mr. McConnell was in</p> <p>18 charge. I reviewed the hospital</p> <p>19 operations and what existing contracts</p> <p>20 there were between the hospitals and</p> <p>21 various physician groups and things like</p> <p>22 that.</p> <p>23 Q. To your knowledge -- well, strike</p> <p>24 that.</p> <p>25 MR. McDONOUGH: Why don't we</p>   |

TAB 190

**In The Matter Of:**

*AHERF v.*  
*PRICEWATERHOUSECOOPERS, LLP*

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**ROBERT BERLINER**  
*February 16, 2005*

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**BERLINER, ROBERT - Vol. 1**





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1 Robert Berliner  
 2 had many other brands.  
 3 Q. Have you ever had in your career  
 4 any other experience like the one that you  
 5 described at American Beverage?  
 6 A. Yes, I did.  
 7 Q. What was that experience?  
 8 A. It was with a company called  
 9 Nickelberry that had been a long-standing client  
 10 of our Chicago office where there was a  
 11 management change and the company relocated to  
 12 New York. The company took a position that they  
 13 had made a decision to dispose of a line of  
 14 business during the year and therefore in the  
 15 financial statements they wanted to release they  
 16 categorized the operations of this line of  
 17 business as a discontinued operation.  
 18 I'll never forget the situation, we  
 19 were working lengthy hours and one night about  
 20 8:30 I asked my team, I was the partner and I  
 21 asked my team look, I've got to leave now, is  
 22 there anything I can read on the train and the  
 23 answer was well, why don't you take the minutes  
 24 of the board of directors. So I took the  
 25 minutes of the board of directors meetings and

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1 Robert Berliner  
 2 I'm on the train reading these minutes and it  
 3 suddenly dawns on me that haven't I read this  
 4 part before, didn't I see this movie. I picked  
 5 up what I thought I had seen and there I had in  
 6 my hands two versions, two very different  
 7 versions of the same board meeting with respect  
 8 to this discontinuance of the business, and in  
 9 fact they had not made any decision to  
 10 discontinue the business.  
 11 I went back to the CEO and I said  
 12 to him as politely as I could how can you  
 13 account for the fact that what you told me --  
 14 which of these two board minutes is correct and  
 15 he blew it, he got all upset and everything and  
 16 lost his temper. Bottom line, we took the  
 17 discontinued operations, reflected them as  
 18 current operations, issued the financial  
 19 statements that way and two months later he  
 20 appeared in our office to speak to the managing  
 21 partner of the office to tell him we were being  
 22 fired and replaced as auditors because your  
 23 audit partner wouldn't let me put out the false  
 24 financial statements that I wanted to put out.  
 25 I'm use to dealing with managements

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1 Robert Berliner  
 2 that are not all that forthcoming and indeed  
 3 managements that lie. Whether they do or not  
 4 that does not absolve an auditor of his  
 5 responsibilities, otherwise where is the auditor  
 6 the watchdog for the public, readers of  
 7 financial statements count on the auditor to do  
 8 an audit.  
 9 That's why earlier in the day I  
 10 wanted to comment when you asked me about the  
 11 management representation letter being an  
 12 important procedure, of course it's an important  
 13 procedure but on the other hand what is it, of  
 14 course you have to get these representations  
 15 from management, but that is by no means the  
 16 corroboration or the end of what you're supposed  
 17 to do. I'm sorry for this prolonged answer, but  
 18 I couldn't resist given the question you asked.  
 19 Q. I can see that. Have you had any  
 20 other experiences in your career like American  
 21 Beverage or Nickleberry?  
 22 A. I did, but not all of them that I  
 23 can recollect or stand out at this time.  
 24 Q. There aren't any others that come  
 25 to mind at this time?

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1 Robert Berliner  
 2 A. Correct.  
 3 MR JONES: Let's take a short  
 4 break.  
 5 THE VIDEOGRAPHER: This marks the  
 6 end of tape number 2 in the deposition of Robert  
 7 Berliner. We are going off the record, the time  
 8 is approximately 2:15 p.m.  
 9 (Short recess taken.)  
 10 THE VIDEOGRAPHER: We are back on  
 11 the record. Here marks the beginning of tape  
 12 number 3 in the deposition of Robert Berliner,  
 13 the time is 2:28 p.m.  
 14 A. Mr. Ryan, may I add to the record  
 15 with respect to the Kite testimony?  
 16 Q. Yes, please.  
 17 A. I just checked with my colleague  
 18 Mr. Zatkow and it's his recollection that we  
 19 received the final report of Mr. Kite just prior  
 20 to issuing our report, which had been drafted  
 21 based upon the oral assurances that Mr. Kite  
 22 gave us as to what his opinions would say on the  
 23 management we were interested in.  
 24 Q. As you understand it you didn't  
 25 receive the report from Mr. Kite until a matter



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1 Robert Berliner  
 2 of days before you submitted your report?  
 3 A. That's correct.  
 4 Q. You in fact had already drafted  
 5 what was in the report based on an oral  
 6 communication of Mr. Kite's views?  
 7 A. That's correct.  
 8 Q. Thank you. Is it your  
 9 understanding that in fiscal 1997 AHERF  
 10 management decided to engage Coopers & Lybrand  
 11 to perform only an audit of the consolidated  
 12 system rather than additionally perform separate  
 13 audits of certain affiliates or obligated  
 14 groups?  
 15 MR. JONES: Object to form.  
 16 A. I think I know where you're going  
 17 and the answer is basically yes, although I  
 18 would have used different words. It was to  
 19 report on, they couldn't audit the consolidated  
 20 without also auditing the consolidating, but the  
 21 report that I think you're talking about was an  
 22 audit opinion on the consolidated, as opposed to  
 23 1996 where they gave separate audit opinions on  
 24 the obligated groups.  
 25 Q. That was a change in the scope of

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1 Robert Berliner  
 2 work for Coopers & Lybrand from one year to the  
 3 next, right?  
 4 A. Again that needs commentary, it's  
 5 not an easy answer to that question. There is a  
 6 yes and a no. The no is that no, they still had  
 7 to audit the books and records of the various  
 8 components to be able to reach an opinion on the  
 9 consolidated financial statements, that's how  
 10 you audit, you audit the books of each of the  
 11 components in the consolidated financial  
 12 statements. The way the scope changes is that  
 13 the opinion that they would express on the  
 14 consolidating information would be in all  
 15 respects material to the consolidated.  
 16 As a result thereof, the audit  
 17 scope in terms of materiality, the materiality  
 18 threshold drops from what would be material to  
 19 the individual obligated groups -- I'm sorry, it  
 20 doesn't drop, it increases to the materiality on  
 21 the consolidated financials taken as a whole so  
 22 that less work would be required to give the  
 23 opinion that was given on the consolidating,  
 24 then if the audit firm had to report  
 25 individually on each of the obligated groups.

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1 Robert Berliner  
 2 Q. So there was a more lenient  
 3 standard of materiality in 1997 than there had  
 4 been in the previous years?  
 5 A. Yes.  
 6 MR. JONES: Object to form.  
 7 Q. Do you agree that because of this  
 8 change in reporting format, Coopers & Lybrand's  
 9 audit in fiscal year 1997 was conducted for the  
 10 purpose of forming an opinion on the  
 11 consolidated financial statements taken as a  
 12 whole?  
 13 MR. JONES: Object to form.  
 14 A. Again, my answer is yes and no.  
 15 Yes to the extent that that was the only audit  
 16 opinion expressed. No in that to be able to  
 17 express that opinion there had to be extensive  
 18 work on the various components, and particularly  
 19 to enable Coopers to be in a position to issue  
 20 its debt compliance letters in connection with  
 21 the various loan covenants. So there was a  
 22 modification, but it didn't go from auditing the  
 23 individual obligating groups to not auditing  
 24 them at all.  
 25 Q. Do you agree that in fiscal year

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1 Robert Berliner  
 2 1997 Coopers & Lybrand was not required to  
 3 conduct an audit for the purpose of forming an  
 4 opinion on the financial statements of DVOG?  
 5 MR. JONES: Object to form.  
 6 A. Yes, there was no reason to express  
 7 an audit opinion on DVOG because a client didn't  
 8 request that opinion, but still with respect to  
 9 the debt compliance letters, the auditing work  
 10 that was done on DVOG and also the auditing work  
 11 on DVOG in order to form an opinion on the  
 12 consolidated financials taken in a whole  
 13 required extensive auditing procedures to be  
 14 applied to DVOG's books and records.  
 15 Q. Do you agree that the supplementary  
 16 consolidating financial information for DVOG in  
 17 1997 was subjected to the auditing procedures  
 18 applied in the audit of the consolidated AHERF  
 19 financial statements?  
 20 A. Yes, I do.  
 21 Q. This change in the report that  
 22 Coopers & Lybrand was providing is something  
 23 that is apparent to any reader of the financial  
 24 statements, is it not?  
 25 MR. JONES: Object to form and



Page 157

1 Robert Berliner

2 foundation.

3 A. What's apparent is they are not  
4 getting a separate audit report on the  
5 individual obligated groups, but they are  
6 getting in lieu thereof a report on the  
7 consolidating information.

8 Q. This change in Coopers & Lybrand's  
9 reporting obligation was apparent to the AHERF  
10 board of trustees, right?

11 MR. JONES: Object to foundation  
12 and form.

13 A. I guess so, I have no reason to  
14 think otherwise. I don't know for sure to what  
15 extent the board of trustees examined the  
16 financial statements, I would think they would.

17 Q. Do you agree that this change in  
18 Coopers & Lybrand's, the reporting obligation  
19 was also apparent to lenders?

20 MR. JONES: Same objection,  
21 foundation and form.

22 A. I believe the quid pro quo here was  
23 that in lieu of separate audit reports on the  
24 individual obligated groups, the lenders would  
25 receive a report on the consolidated and a

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1 Robert Berliner

2 in reporting format complied with the obligated  
3 group debt agreements?

4 A. I am aware of that. I also want to  
5 modify what I just said. The board of trustees  
6 did review the financial statements and did  
7 attach importance to the earnings that were  
8 recorded therein.

9 Q. Do you agree with me that as a  
10 result of the change in reporting format, the  
11 reader of the financial statements was no longer  
12 informed of what the bad debt allowance was at  
13 individual obligated groups?

14 A. That's correct.

15 Q. And was no longer informed of what  
16 that debt expense was at different obligated  
17 groups?

18 A. That's correct.

19 Q. And was no longer informed of  
20 related party transactions, that is transactions  
21 within the AHERF system?

22 A. Correct.

23 Q. Are these in your view then  
24 significant reductions in the level of  
25 information about DVOG that were provided in

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1 Robert Berliner

2 report, separate report on the consolidating.  
3 While a sophisticated lender would realize that  
4 the report on the consolidating would give  
5 somewhat less assurance let's say on the  
6 fairness of presentation of the financial  
7 statements of DVOG, the lender would also  
8 realize that the report on the consolidating did  
9 evidence the fact that auditing procedures were  
10 applied on the individual components.

11 Just Mr. Ryan as you read to me for  
12 the purpose of expressing an opinion on the  
13 consolidated, so they would realize that they  
14 were still getting audited financial statements  
15 of the individual obligated groups -- sorry,  
16 that they were not getting audited financial  
17 statements of the individual obligated groups,  
18 but they were getting an opinion on the  
19 consolidating and that were there to be any  
20 material departures from GAAP that were detected  
21 in the audit of the consolidated financial  
22 statements they would be brought to their  
23 attention.

24 Q. Are you aware that Foley & Lardner  
25 provided a legal opinion saying that this change

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1 Robert Berliner

2 1997 as compared to 1996?

3 A. They are reductions, yes.

4 Q. Do you believe that they are  
5 significant reductions?

6 MR. JONES: Object to form.

7 A. I believe they are significant  
8 reductions.

9 Q. And they are apparent to any reader  
10 of the financial statements who cares to examine  
11 them, right?

12 MR. JONES: Objection to  
13 foundation.

14 A. The sheer absence of footnotes on  
15 the individual components is a significant  
16 reduction of information.

17 Q. Do you have any view one way or the  
18 other as to whether the legal opinion from Foley  
19 & Lardner was reasonable?

20 A. No, I can't evaluate on a law  
21 firm's opinion.

22 Q. Nor would you have expected Coopers  
23 & Lybrand to have been in a position to second  
24 guess Foley & Lardner's opinion, would you?

25 MR. JONES: Object to form.



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1 Robert Berliner  
 2 appropriate procedure, and so they gave  
 3 assurance to someone that nothing came to their  
 4 attention in the performance of their work on  
 5 this procedure to indicate that the account was  
 6 overstated, that conveys false assurance to the  
 7 recipient of that letter, but it's attributable  
 8 to the audit failure as opposed to a false  
 9 communication, an intentionally false  
 10 communication.  
 11 Q. Have you learned that AHERF  
 12 management and the law firm of Foley & Lardner  
 13 discovered the error in calculating the Morgan  
 14 Guarantee Trust consolidated unrestricted fund  
 15 balance covenant before the release of the  
 16 fiscal 1997 audited financial statements?  
 17 A. I don't recall.  
 18 Q. Have you heard of the law firm of  
 19 Foley & Lardner?  
 20 A. Yes.  
 21 Q. It is a reputable law firm?  
 22 A. As far as I know.  
 23 Q. If you were an auditor would you be  
 24 upset if you learned that your client had a  
 25 reputable law firm like Foley & Lardner that

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1 Robert Berliner  
 2 knew of debt covenant noncompliance and didn't  
 3 take any action to have their client tell you,  
 4 the auditor, about it?  
 5 MR. JONES: Object to the  
 6 hypothetical.  
 7 A. I would be upset.  
 8 MR. RYAN: We need to change the  
 9 tape.  
 10 THE VIDEOGRAPHER: This marks the  
 11 end of tape number 3 in the deposition of Robert  
 12 Berliner. We are going off the record, the time  
 13 is approximately 4:33 p.m.  
 14 (Short recess taken.)  
 15 THE VIDEOGRAPHER: We are back on  
 16 the record. Here marks the beginning of tape  
 17 number 4 in the deposition of Robert Berliner,  
 18 the time is approximately 4:46 p.m., you can  
 19 begin.  
 20 Q. Mr. Berliner, do you agree that an  
 21 audit is designed to provide only reasonable  
 22 assurance of discovering material in the state  
 23 that they exist?  
 24 A. I do.  
 25 Q. An audit is not designed too

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1 Robert Berliner  
 2 provide absolute assurance, is it?  
 3 A. It is not.  
 4 Q. An audit is not a guarantee, is it?  
 5 A. It is not.  
 6 Q. An auditor is not an insurer, is  
 7 he?  
 8 A. He is not.  
 9 Q. Do you agree that the subsequent  
 10 discovery that a material misstatement exists in  
 11 the financial statements does not in and of  
 12 itself evidence inadequate planning, performance  
 13 or judgment on the part of the auditor?  
 14 MR. JONES: Object to form.  
 15 A. I agree.  
 16 Q. Do you agree that there are certain  
 17 inherent limitations of an audit?  
 18 A. I agree.  
 19 Q. For instance, auditors only come in  
 20 for a short period of time to conduct their  
 21 audit testing?  
 22 A. Relatively speaking, yes.  
 23 Q. Do you agree that an auditor cannot  
 24 test 100 percent of the transactions of a  
 25 company, right?

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1 Robert Berliner  
 2 A. Well, it's not practical for the  
 3 auditor to do so.  
 4 Q. That's part of the inherent  
 5 limitations to an audit to which we were  
 6 referring to?  
 7 A. Yes.  
 8 Q. As a result of that fact, is the  
 9 concept of selective testing generally accepted  
 10 as a valid and sufficient basis for the auditor  
 11 to base his opinion on?  
 12 A. It is.  
 13 Q. Selective testing is also referred  
 14 to sometimes as sampling, right?  
 15 A. Yes.  
 16 Q. So that an auditor may in  
 17 conducting his audit conduct procedures only on  
 18 a sample of the accounts or on a sample of  
 19 transactions, right?  
 20 A. Yes.  
 21 Q. That is in accordance with GAAS,  
 22 right?  
 23 A. It is.  
 24 Q. Now if an auditor complies with  
 25 GAAS and does not find material misstatement,

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1 Robert Berliner  
 2 that doesn't necessarily mean he didn't do his  
 3 job properly, does it?  
 4 A. That's right.  
 5 Q. Do you have a sense of how many  
 6 entries there would be in a given year to the  
 7 contractual allowance accounts at AHERF?  
 8 A. Thousands.  
 9 Q. Of which \$28 million transferred  
 10 from Graduate to the contractual allowance  
 11 accounts at DVOG would be only a handful, right?  
 12 A. Yes.  
 13 Q. Do you agree that if an auditor  
 14 were auditing the contractual allowance account  
 15 which included thousands of journal entries, an  
 16 auditor would not test each of the thousands of  
 17 journal entries recorded throughout the year in  
 18 the general ledger?  
 19 A. I agree.  
 20 Q. Would it be fair to say that an  
 21 auditor is not responsible for recording entries  
 22 into the books and records of the company?  
 23 A. That's correct.  
 24 Q. That's the job of the company and  
 25 its personnel, right?

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1 Robert Berliner  
 2 A. That correct.  
 3 Q. As part of the concept I think we  
 4 mentioned before that the financial statements  
 5 are the responsibilities of management?  
 6 A. That's correct.  
 7 Q. Would you agree that the auditor's  
 8 primary concern is not with individual  
 9 transactions or individual journal entries, but  
 10 with the financial statements taken as a whole?  
 11 MR. JONES: Object form.  
 12 A. That is the auditors primary  
 13 concern, yes.  
 14 Q. Would you agree that an audit  
 15 performed in accordance with GAAS is not  
 16 designed to provide an opinion on the  
 17 effectiveness of internal controls?  
 18 MR. JONES: Object to form.  
 19 A. Yes, I do.  
 20 Q. Do you agree that an audit  
 21 performed in accordance with GAAS is also not  
 22 designed to provide an opinion on the  
 23 qualifications or effectiveness of company  
 24 personnel?  
 25 A. Yes.

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1 Robert Berliner  
 2 Q. Do you agree that an audit  
 3 performed in accordance with GAAS is also not  
 4 designed to provide an opinion on company  
 5 business strategies?  
 6 A. Yes.  
 7 Q. Do you agree that an auditor has to  
 8 rely on his professional judgment in carrying  
 9 out his audit?  
 10 A. I agree.  
 11 Q. Do you agree that judgment is  
 12 pervasive throughout every aspect of an audit?  
 13 A. I agree.  
 14 Q. There are literally hundreds of  
 15 judgments that are made by an auditor in the  
 16 course of even the most straightforward audit,  
 17 isn't that right?  
 18 MR. JONES: Object to form.  
 19 A. Hundreds of judgments?  
 20 Q. Yes.  
 21 A. It depends upon the entity I guess.  
 22 Q. For an entity as large as AHERF,  
 23 the whole AHERF system, there would be hundreds  
 24 of judgments that would be made during the  
 25 course of the audit?

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1 Robert Berliner  
 2 A. Yes, I agree.  
 3 Q. Generally there is no right or  
 4 wrong answer to any of these matters, right?  
 5 MR. JONES: Object to form and  
 6 foundation.  
 7 A. Any of what matters?  
 8 Q. The matters on which an auditor  
 9 exercises judgment.  
 10 MR. JONES: Object to form and  
 11 foundation.  
 12 Q. There is no single right answer.  
 13 There may be an array of different right answers  
 14 might be a better way of putting it, is that a  
 15 fair way of saying it?  
 16 MR. JONES: Same objection.  
 17 A. I'm not sure of that. I can  
 18 envision circumstances where there would be a  
 19 right answer.  
 20 Q. And others in which there might be  
 21 a range of right answers?  
 22 A. Correct.  
 23 Q. Would you agree that management  
 24 possesses knowledge about his business that  
 25 generally is substantially greater than that of



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1 Robert Berliner  
 2 the outside auditors?  
 3 A. I agree.  
 4 Q. That's because the transactions of  
 5 the entity and its related assets and  
 6 liabilities are within the direct knowledge and  
 7 control of management, isn't it?  
 8 A. Yes, it is.  
 9 MR. JONES: Objection to form and  
 10 foundation.  
 11 Q. The auditor's knowledge of these  
 12 matters is limited to that acquired through the  
 13 audit, isn't it?  
 14 A. That is correct.  
 15 MR. JONES: Same objection.  
 16 Q. When we say that the financial  
 17 statements are the responsibility of management,  
 18 does that also mean that management is  
 19 responsible for preparing the financial  
 20 statements in accordance with GAAP?  
 21 A. That's correct.  
 22 Q. Is management responsible for  
 23 adopting sound accounting policies?  
 24 A. It is.  
 25 Q. Is management responsible for

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1 Robert Berliner  
 2 maintaining the accounting records?  
 3 A. Yes.  
 4 Q. And for recording its transactions  
 5 throughout the year?  
 6 A. Yes.  
 7 Q. Is establishing and maintaining an  
 8 internal control structure also an important  
 9 management responsibility?  
 10 A. It is.  
 11 Q. What are the reasons that  
 12 management establishes internal controls?  
 13 A. There are many reasons. With  
 14 respect to the financial statements it's to  
 15 assure that they are able to prepare financial  
 16 statements that fairly present in accordance  
 17 with GAAP and to assure against the  
 18 misappropriation of their assets.  
 19 Q. You agree that no internal control  
 20 system can provide absolute assurance that the  
 21 financial statements will be prepared in  
 22 accordance with GAAP?  
 23 A. I agree.  
 24 Q. If that happens, that is that the  
 25 financial statements are not prepared in

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1 Robert Berliner  
 2 accordance with GAAP, do you agree that that  
 3 does not mean that the internal control system  
 4 in place is necessarily deficient?  
 5 A. Yes.  
 6 Q. Do you agree that it's probably  
 7 very difficult, if not impossible, to design an  
 8 internal control system that would catch even  
 9 immaterial errors?  
 10 MR. JONES: Object to form.  
 11 A. Yes.  
 12 Q. You agree that the auditors do not  
 13 play a role in the day-to-day monitoring of the  
 14 internal control system?  
 15 A. Yes.  
 16 Q. Do you agree with me that  
 17 management has various obligations to the  
 18 auditor, including that management is supposed  
 19 to be responsive to the auditor's inquiries?  
 20 A. Yes.  
 21 Q. Do you agree with me that  
 22 management is supposed to furnish the auditor  
 23 with assistance in locating documents?  
 24 A. Yes.  
 25 Q. Do you agree that management is

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1 Robert Berliner  
 2 supposed to produce evidence that the auditor  
 3 asks to see?  
 4 A. Yes.  
 5 Q. Do you agree with me that  
 6 frequently auditors ask the management to have  
 7 client's personnel prepare certain schedules  
 8 that the auditor incorporates in his working  
 9 papers?  
 10 A. Yes.  
 11 Q. Do you believe that management has  
 12 an obligation to cooperate with the auditor in  
 13 terms of those requests?  
 14 A. Yes.  
 15 Q. Do you agree with me that  
 16 management is obligated to tell the auditors the  
 17 truth?  
 18 MR. JONES: Object to form and  
 19 foundation.  
 20 A. Yes.  
 21 Q. Do you agree with me that  
 22 management is obligated not to withhold any  
 23 material information?  
 24 A. Yes.  
 25 MR. JONES: Object to form and

|   |   |
|---|---|
| <p style="text-align: right;">Page 245</p> <p>1 Robert Berliner</p> <p>2 foundation.</p> <p>3 Q. Do you agree with me that if</p> <p>4 management lies to an auditor or withholds</p> <p>5 pertinent information from an auditor,</p> <p>6 management has breached its obligations to the</p> <p>7 auditor?</p> <p>8 MR. JONES: Objection to form and</p> <p>9 foundation.</p> <p>10 A. Yes.</p> <p>11 Q. Do you agree with me that the</p> <p>12 position of trust between the auditor and the</p> <p>13 client lies at the very heart of the audit</p> <p>14 process?</p> <p>15 A. Yes.</p> <p>16 Q. Do you agree with me that the</p> <p>17 auditor has to be in a position where the</p> <p>18 auditor can rely on the honesty and truthfulness</p> <p>19 of what the auditor is told by his clients?</p> <p>20 MR. JONES: Objection to form and</p> <p>21 foundation.</p> <p>22 A. Yes.</p> <p>23 Q. Do you agree with me that during</p> <p>24 audits management is responsible for disclosing</p> <p>25 to the independent auditors sufficient and</p>   | <p style="text-align: right;">Page 247</p> <p>1 Robert Berliner</p> <p>2 believe management has an obligation to be</p> <p>3 responsive to those inquiries. There is certain</p> <p>4 information I believe that management, as we've</p> <p>5 been discussing, should divulge to their</p> <p>6 auditors, but the question is so general it</p> <p>7 really confuses I think the respective roles of</p> <p>8 management and the auditor in terms of who's</p> <p>9 responsible for the audit. I'm very sensitive</p> <p>10 to this question because of the positions taken</p> <p>11 by Mr. Tillett that I vehemently disagree with</p> <p>12 and I think this is striking right in the face</p> <p>13 of that and is trying to articulate his</p> <p>14 viewpoint with which I disagree.</p> <p>15 Q. Are you able to tell me sir whether</p> <p>16 or not you disagree with the proposition that</p> <p>17 during audits management is responsible for</p> <p>18 disclosing to the independent auditors</p> <p>19 sufficient and relevant information so they may</p> <p>20 conduct their audits?</p> <p>21 MR. JONES: Same objection; asked</p> <p>22 and answered.</p> <p>23 A. I disagree.</p> <p>24 Q. Do you agree that members of</p> <p>25 management who are certified public accountants</p> |
| <p style="text-align: right;">Page 246</p> <p>1 Robert Berliner</p> <p>2 relevant information so they may conduct their</p> <p>3 audits?</p> <p>4 MR. JONES: Object to form.</p> <p>5 A. Could you repeat that, please.</p> <p>6 (Question read.)</p> <p>7 MR. JONES: Object to form.</p> <p>8 A. I really don't know how to answer</p> <p>9 that question, the auditor should know how to</p> <p>10 conduct his audit. So while management should</p> <p>11 be responsive to the auditor's inquiries, I</p> <p>12 don't believe management has a responsibility to</p> <p>13 hold the auditors hand and lead him through the</p> <p>14 audit, as is implied by this particular</p> <p>15 question.</p> <p>16 Q. Let me ask it again to make sure</p> <p>17 we're on the same page, Mr. Berliner. Do you</p> <p>18 disagree with the proposition that during audits</p> <p>19 management is responsible for disclosing to the</p> <p>20 independent auditors sufficient and relevant</p> <p>21 information so they may conduct their audits?</p> <p>22 MR. JONES: Same objection, asked</p> <p>23 and answered.</p> <p>24 A. Again, I think the auditor has an</p> <p>25 obligation to make inquiries of management and I</p> | <p style="text-align: right;">Page 248</p> <p>1 Robert Berliner</p> <p>2 must comply with the AICPA's professional code</p> <p>3 of conduct and not knowingly fail to disclose</p> <p>4 material facts?</p> <p>5 A. I agree.</p> <p>6 Q. Do you agree that if the management</p> <p>7 of an audit client puts its mind to it, the</p> <p>8 management of an audit client can obstruct the</p> <p>9 efforts by the auditing firm?</p> <p>10 A. I agree.</p> <p>11 MR. JONES: Object to form.</p> <p>12 Q. And that that can obstruct the</p> <p>13 efforts of the auditing firm to conduct an audit</p> <p>14 in accordance with GAAS?</p> <p>15 A. Yes.</p> <p>16 MR. JONES: Same objection.</p> <p>17 Q. Let me ask you a question about the</p> <p>18 nature of audit evidence. Do you agree that an</p> <p>19 auditor finds it necessary when conducting an</p> <p>20 audit to rely on evidence that is persuasive</p> <p>21 rather than convincing?</p> <p>22 A. Yes.</p> <p>23 Q. This is a respect in which audit</p> <p>24 evidence differs, for example, from legal</p> <p>25 evidence which is circumscribed by rigid rules?</p>   |

TAB 191



**In The Matter Of:**

*AHERF v.  
PRICEWATERHOUSECOOPERS, LLP.*

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**D. PAUL REGAN**

*March 4, 2005*

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**REGAN, D. PAUL - Vol. 1**





D. PAUL REGAN

|  |   |
|--|---|
| <p style="text-align: right;">Page 161</p> <p>1 BY MR. ROSENTHAL:</p> <p>2 Q And if you don't have an opinion with</p> <p>3 respect to that, feel free to say so.</p> <p>4 A It doesn't appear that it was. It had a</p> <p>5 net loss, it had a net loss in 1996, of June 30,</p> <p>6 1996 of \$12 million, and that was after</p> <p>7 considering investment income of \$74,075,000. So</p> <p>8 there was a substantial loss from the fees that it</p> <p>9 charged. The fees that it charged were less than</p> <p>10 its expenses.</p> <p>11 Q In fact, AHERF financed its operating</p> <p>12 needs largely from private philanthropy and</p> <p>13 government grants in addition to its fees; is that</p> <p>14 right? Do you know?</p> <p>15 A Well, looking at the June 30, 1996</p> <p>16 financial statements, it indicates that of the</p> <p>17 \$1,607,000, net patient service revenue was</p> <p>18 \$1,352,000, which -- I have to get a calculator.</p> <p>19 Q That's all right, I'll withdraw the</p> <p>20 question, Mr. Regan. I don't want to slow us</p> <p>21 down.</p> <p>22 A That's okay. If you ask me another</p> <p>23 question that involves, I'll have the calculator</p> <p>24 out.</p>              | <p style="text-align: right;">Page 163</p> <p>1 "organization." And then after the first</p> <p>2 sentence, it starts with the word "The," and so</p> <p>3 does my paragraph. And in that sentence, the line</p> <p>4 between "Non-business organizations and business</p> <p>5 enterprises is not always sharp," which is a</p> <p>6 quote, and then "Since the incidence and relative</p> <p>7 importance of those characteristics, in any</p> <p>8 organization, are different," yes. Through the</p> <p>9 word "different," it's the same as paragraph 7.</p> <p>10 Q There is nothing intervening between the</p> <p>11 first sentence and the second sentence of your</p> <p>12 paragraph that's in Con 4?</p> <p>13 A No.</p> <p>14 Q Is there any reason why you did not use</p> <p>15 quotation marks around this language, which is</p> <p>16 directly quoted from FASB Concept Number 4?</p> <p>17 A No. I could have, and then put an</p> <p>18 ellipse after the word "different," and then put a</p> <p>19 quote after the ellipse.</p> <p>20 Q Now, in F(iii) at the bottom of page 9,</p> <p>21 you say that, "It appears that the readers of</p> <p>22 AHERF's financial statements were focused on the</p> <p>23 financial performance of AHERF."</p> <p>24 Who were the readers of AHERF's financial</p> |
| <p style="text-align: right;">Page 162</p> <p>1 Q Okay, I would like you to take a look at</p> <p>2 page 9 of your report, Paragraph F(i). Now, in</p> <p>3 this paragraph, you begin with the statement,</p> <p>4 "This statement focuses on organizations that have</p> <p>5 predominantly non-business characteristics that</p> <p>6 heavily influence the operations of the</p> <p>7 organization."</p> <p>8 Do you see that?</p> <p>9 A I do.</p> <p>10 Q Is that a quotation? I realize there are</p> <p>11 no quotation marks here, but is that language a</p> <p>12 direct quotation from some accounting source?</p> <p>13 A It is taken from FASB, Statement of</p> <p>14 Financial Accounting Concepts, Number 4,</p> <p>15 Paragraph 7, and it's not a direct quotation --</p> <p>16 well, hang on, let me see.</p> <p>17 It looks like through the word different,</p> <p>18 it's taken from paragraph 7.</p> <p>19 Q That's not quite right though, is it,</p> <p>20 sir? Through the word "organization," it's taken</p> <p>21 from paragraph 7, and then there are two</p> <p>22 paragraphs in between.</p> <p>23 A Well, I just read the first statement,</p> <p>24 the first sentence, which brings me to the word</p> | <p style="text-align: right;">Page 164</p> <p>1 statements that you refer to in that sentence?</p> <p>2 A What I'm referring to are management and</p> <p>3 members of the board.</p> <p>4 Q And management was responsible for</p> <p>5 preparing the financial statements; is that</p> <p>6 correct?</p> <p>7 A Yes.</p> <p>8 Q Now, on what information, that is,</p> <p>9 documents or testimony, did you base your</p> <p>10 conclusion that it appears that the readers of</p> <p>11 AHERF's financial statements were focused on the</p> <p>12 financial performance of AHERF?</p> <p>13 A With respect to management, what I see is</p> <p>14 a number of comments by C&amp;L and its analysis of</p> <p>15 the control environment, where there are a number</p> <p>16 of comments as to management being aggressive,</p> <p>17 management being very mindful of making budget,</p> <p>18 management being focused on achieving earnings</p> <p>19 expectations, management expressing the opinion</p> <p>20 that they can't afford to write off certain</p> <p>21 assets, because of the impact on budget or the</p> <p>22 bottom line.</p> <p>23 There are a number of references in the</p> <p>24 Coopers &amp; Lybrand working papers, which are driven</p>  |

D. PAUL REGAN

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1 from results of operations, targets and  
2 achievement. I don't see, for example, ever any  
3 discussion of, this is going to hurt our net  
4 assets. It's, It's going to hurt our operations.

5 With respect to the board of directors in  
6 looking at their deposition testimony, and in  
7 reading the minutes, the transcripts of Audit  
8 Committee meetings, I see an emphasis on, for  
9 example, a chair, Mr. Barnes, he is driven by and  
10 very interested in operations.

11 Q Cash flow from operations, isn't that  
12 right, Mr. Barnes?

13 MR. TORBORG: I object to form.

14 BY MR. ROSENTHAL:

15 Q Doesn't the statement that you quote from  
16 Mr. Barnes in your report say that he tended to  
17 emphasize cash flow from operations; is that  
18 correct?

19 MR. TORBORG: I object to form.

20 A The first item of cash flow from  
21 operations is the bottom line of your statement of  
22 operations.

23 BY MR. ROSENTHAL:

24 Q I want to continue to ask you some

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1 questions about management and Mr. Barnes, but  
2 since you mentioned the term "bottom line," can I  
3 ask you, what is the bottom line on AHERF's  
4 financial statements, the actual bottom line on  
5 the statement of operations?

6 A Well, I always equate bottom line with  
7 the words "net income," which is on the statement  
8 of operations of AHERF.

9 If you look at the AHERF financial  
10 statements, say, of June 30, 1996, my  
11 interpretation of the bottom line is the net loss  
12 of \$11,837,000. There's three other numbers that  
13 fall below it to have a modest impact, and brings  
14 that number down to a loss of, or a decrease in  
15 unrestricted net assets of \$8,007,000.

16 Q I apologize for asking a simplistic  
17 question, but my question is not how do you  
18 interpret the phrase "bottom line." I'm asking  
19 you, what is the actual last line on the bottom of  
20 the page of the AHERF statement of operations?

21 A The company notes are an integral part of  
22 the consolidated financial statements.

23 Q The last line, not the note.

24 A Oh, a number, the last line with a

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1 number? Decrease in unrestricted net assets.

2 Q Whereas if you were to look at the  
3 financial statements of a for-profit company, the  
4 last line, the bottom line would be income,  
5 correct?

6 A It would probably be fully diluted  
7 earnings per share.

8 Q Well, there is an earnings per share  
9 calculation that's below the income statement --

10 A Yes, the bottom line you're just talking  
11 about. So your bottom line is different than the  
12 bottom line we're talking -- (indicating)

13 Q Where is the income line?

14 A Do I go to the bottom line that says,  
15 Fully diluted earnings per share?

16 Q Where does the income line occur in the  
17 bottom of a statement of income for a for-profit  
18 organization?

19 MR. TORBORG: I object to form,  
20 foundation.

21 THE WITNESS: Can I hear that question  
22 again?

23 (Question read)

24 A I don't understand your question, now

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1 that you've confused me about this bottom line  
2 process. Because on a for-profit, the bottom line  
3 is typically, fully diluted earnings per share.

4 BY MR. ROSENTHAL:

5 Q If you were confused by my question, I  
6 apologize. We will leave it at that.

7 What is the title of the statement which  
8 contains revenue, expenses, et cetera, for AHERF?

9 A In 1996, it's called a Statement of  
10 Operations.

11 Q And in your experience with a for-profit  
12 corporation, are they generally called a statement  
13 of income for operations?

14 A A lot of times they're called statement  
15 of operations.

16 Q Now, a short while ago, you had referred  
17 to evidence that you had seen in the Coopers &  
18 Lybrand work papers of a management interest in  
19 maximizing income.

20 Some of the examples that you cited,  
21 could they be information that you saw, not in the  
22 Coopers & Lybrand work papers, but in the numerous  
23 examples of internal AHERF management documents  
24 that you cite in your report?

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1 A I would expect that there are some  
2 documents, or AHERF documents that make that  
3 statement. For example, the statement that "We  
4 can't afford to write off these assets," or "We  
5 can't afford to establish an appropriate bad debt  
6 reserves," that's a statement that I recall as an  
7 AHERF management document.

8 Q That's the one I was thinking of, thank  
9 you.

10 Now, you also, did you read Mr. Barnes'  
11 entire deposition or just portions of it?

12 A My expectation is that I read portions of  
13 that deposition.

14 Q Do you recall whether the portions of the  
15 deposition in the portions of the deposition that  
16 you read, Mr. Barnes testified that he did his own  
17 calculation of cash flow from the AHERF financial  
18 statements?

19 A That's consistent with my recollection,  
20 yes.

21 Q And that he didn't put a lot of stock in  
22 the net income number?

23 MR. TORBORG: I object to form.  
24

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1 the audit?

2 THE WITNESS: Can I hear that question  
3 again, please.

4 (Question read)

5 A I don't know that I'd phrase it that  
6 way. I was looking to whether or not the working  
7 papers of Coopers & Lybrand indicated to me that  
8 Coopers & Lybrand knew or would have known that  
9 there were GAAP failures, had Coopers & Lybrand  
10 chosen to look at the relevant records or  
11 sufficient competent records which would have been  
12 made available to them if asked, or they would  
13 have seen if they looked.

14 BY MR. ROSENTHAL:

15 Q I understand that's the way you would put  
16 your opinion. I'm asking you a question, however,  
17 and my question is did you look to see if there  
18 were instances where AHERF management withheld  
19 information from the Coopers & Lybrand auditors  
20 that would have been significant to the audits?

21 A I did not focus on that issue.

22 Q You didn't look for it --

23 MR. TORBORG: I object to form.  
24

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1 BY MR. ROSENTHAL:

2 Q Do you recall reading that in Mr. Barnes'  
3 deposition?

4 MR. TORBORG: I object to form.

5 A I'd need to see that testimony.

6 BY MR. ROSENTHAL:

7 Q Do you recall in reading the deposition  
8 testimony, Mr. Barnes' deposition testimony,  
9 whether he made the statement that he thought the  
10 quality of earnings for AHERF for 1996 were very  
11 poor?

12 A I don't have a specific recollection of  
13 reading that.

14 Q We talked earlier about your credentials  
15 as a certified fraud examiner. Did you bring any  
16 of those credentials to bear in examining the  
17 conduct of management, AHERF management in this  
18 case?

19 A No, I didn't look at my role or my scope  
20 of my work as being a fraud examiner.

21 Q Did you look to see if there were  
22 instances where AHERF management withheld  
23 information from the Coopers & Lybrand auditors  
24 that would have been significant to the conduct of

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1 BY MR. ROSENTHAL:

2 Q -- to see whether there were such  
3 instances?

4 A No, I looked to whether or not the  
5 information that was collected by Coopers &  
6 Lybrand and the kind of records that were made  
7 available to it, when married to the type of GAAP  
8 failures that were identified, would have provided  
9 C&L with the information that there was a  
10 misstatement, or it would have alerted C&L to the  
11 need for reviewing the books of the original entry  
12 and other available documents to cure whatever  
13 deficiencies in a sufficient competent evidential  
14 manner existed in connection with an analysis of  
15 an account or accounts.

16 Q So is it possible, sir, that there were  
17 instances where AHERF management withheld  
18 information from Coopers & Lybrand that would have  
19 been significant to the audits, but you did not  
20 look for them?

21 MR. TORBORG: I object to form.

22 A That's not something that I did. But it  
23 became, I think, clear to me that the failings of  
24 GAAP resided within the financial statements, in



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1 the accounting records; and that Coopers & Lybrand  
2 was aware or would have been aware of those  
3 failings had they looked at the appropriate  
4 records, which I have every reason to believe were  
5 made available to it.

6 BY MR. ROSENTHAL:

7 Q Which appropriate records are you  
8 referring to and why do you believe they were made  
9 available?

10 MR. TORBORG: I object to form.

11 Compound.

12 A Journal entries, general ledgers, agings  
13 of accounts payable and application of percentages  
14 of reserves for bad debts on those percentages,  
15 and the depositions of AHERF persons who indicate  
16 that when they were asked for records by Coopers &  
17 Lybrand, they made those records available; and  
18 when they were asked questions by Coopers &  
19 Lybrand, they answered the questions that were  
20 asked.

21 BY MR. ROSENTHAL:

22 Q Are you aware of whether there were  
23 internal schedules used by AHERF management that  
24 contained notes which detailed some of the matters

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1 that you have concluded were accounting  
2 irregularities, and yet when those, when similar  
3 schedules were provided to Coopers, some of those  
4 notes were removed? Are you aware of that fact?

5 A I'm aware, for example, that Coopers was  
6 given schedules which did not have all of the  
7 words which are on other schedules. Whether, when  
8 Coopers was given those schedules, they were  
9 removed, I don't know the answer to that question.  
10 It could be that they were merely given schedules  
11 which did not contain notes that were made by  
12 others or at a later time.

13 Q And would you agree that all of the words  
14 in your last answer were significant words that  
15 would have alerted the auditors to the potential  
16 existence of accounting irregularities?

17 A I would agree that in the example I'm  
18 thinking of, those words are yet one way in which  
19 it would have led C&L to have a better  
20 understanding of the transactions, but that that  
21 was only one of the ways in which Coopers would  
22 have found out; and that the better records are in  
23 fact the journal entries themselves, the books of  
24 original entry of AHERF, and they certainly were

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1 on those books of original entry rather than the  
2 spreadsheets you're talking about.

3 Q Sir, is it the case that auditors in the  
4 course of performing a GAAS audit don't audit all  
5 of the general ledger and journal entries of the  
6 company, as a general matter?

7 A As a general matter, they select entries  
8 of interest based upon risk assessment and  
9 knowledge of the facts and circumstances they gain  
10 as a result of their audit or audit plan.

11 Q And might an auditor choose to select  
12 certain journal entries for examination, if  
13 presented with a schedule that had such a footnote  
14 as we've been discussing? Might that direct the  
15 auditor to examine the journal entries that you're  
16 describing?

17 A If there is such a footnote, I think it  
18 might make the task a bit easier. However, in  
19 this circumstance, I think the auditor, there is  
20 overwhelming reason for the auditor to examine the  
21 entries which were listed on that page, given the  
22 size of the entries, the effect of the entries on  
23 DVOG, and the probability of where those entries  
24 were coming from.

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1 Q But you agree that the presence of the  
2 footnote would certainly be likely to cause the  
3 auditor to check, a reasonable auditor to check  
4 the underlying journal entries?

5 MR. TORBORG: I object to form.

6 A I think the auditor is going to be doing  
7 that anyway, given the nature of the analysis. He  
8 doesn't need to be grabbed by the nose and pushed  
9 into the garbage. I mean, he's going to look at  
10 those entries anyway, or she.

11 BY MR. ROSENTHAL:

12 Q Are you aware, sir, that the person  
13 principally responsible for making the journal  
14 entries in this area of DVOG's books has testified  
15 in this case that she knew Coopers did not  
16 generally audit those journal entries?

17 MR. TORBORG: I object to form and  
18 misstates prior testimony.

19 MR. ROSENTHAL: To hell it does.

20 MR. TORBORG: Okay.

21 MR. WHITNEY: I move to strike that.

22 A That would strike me as disingenuous,  
23 because there hadn't been such entries in the  
24 past. There hadn't been entries where





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1 BY MR. ROSENTHAL:

2 Q My question is a little different than  
3 the one you're answering, sir. My question is not  
4 whether or not withstanding any efforts by  
5 management to conceal information, Coopers &  
6 Lybrand could have nonetheless detected it.

7 I'm simply asking whether you saw any  
8 evidence during the 15,000-plus hours that your  
9 team worked on this matter over four years' time  
10 of management concealing information from  
11 Coopers & Lybrand?

12 MR. TORBORG: I object to form.

13 A For example, I noted the document that  
14 you describe with respect to the notes, but I  
15 don't consider that evidence of a concealment.  
16 It's evidence that there is another version of a  
17 document that doesn't have as many notes as  
18 another version of a document. To me, that didn't  
19 matter.

20 These are entries in an area of high risk  
21 and entries in an area where the entries, the  
22 books of original records that are under  
23 examination need to be reviewed. Evidence needs  
24 to be gathered about those journal entries, not

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1 spreadsheets. Just look at the journal entries,  
2 that's what you're auditing. That's what's  
3 important to me.

4 Q Did you identify in the 15,000 plus hours  
5 that your team worked on this matter over four  
6 years' time, any evidence of management  
7 withholding information from Coopers & Lybrand?

8 MR. TORBORG: I object to form.

9 A I didn't identify any meaningful behavior  
10 which I would describe in that way. Certainly I  
11 read the testimony you described, where the  
12 interviewee was to answer the questions asked. It  
13 is not uncommon, it is not surprising, and I don't  
14 view that as significant to my findings, because  
15 of the other facts and circumstances that were in  
16 place, the other information that was available  
17 that is more competent and more appropriate to be  
18 reviewed.

19 BY MR. ROSENTHAL:

20 Q Sir, you understand I'm not asking you  
21 whether these facts would be significant to your  
22 findings. I'm just asking whether you identified  
23 such facts. Do you understand that that's my  
24 question?

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1 MR. TORBORG: I object to the instruction  
2 and I object to form.

3 MR. ROSENTHAL: It's not an instruction.  
4 I'm seeking to determine whether the witness  
5 understands my question, since each time I ask  
6 him, he answers by answering a question I did  
7 not ask.

8 MR. TORBORG: I object to the  
9 introduction, and I object to the form.

10 MR. ROSENTHAL: And I object to the  
11 speaking objections.

12 A Is there a question?

13 BY MR. ROSENTHAL:

14 Q Do you understand that my questions are  
15 not about whether or not such facts, if you  
16 discovered them, would have been significant to  
17 your findings.

18 I'm simply asking whether you came across  
19 facts in the course of four plus years' work on  
20 this matter, where you saw evidence of management  
21 concealing information, management withholding  
22 information, and I have a few other in the same  
23 vein, but do you understand that my questions are  
24 not about whether they go to your opinion about

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1 the adequacy of the audit?

2 MR. TORBORG: Objection. That question  
3 has been asked and answered at least four  
4 times in this deposition.

5 MR. ROSENTHAL: It's been asked, it  
6 hasn't been answered.

7 MR. TORBORG: It has been answered. It's  
8 because you have an idea of what you believe  
9 the word "withholding" means and what you  
10 believe the word "concealment" means --

11 MR. ROSENTHAL: This is so beyond the  
12 bounds of acceptable objections. This gives  
13 new meaning to speaking objections.

14 MR. TORBORG: You are berating our  
15 witness for not answering questions and he has  
16 answered questions.

17 MR. ROSENTHAL: The witness has  
18 considerably more experience answering  
19 questions than I have asking them. I think he  
20 can handle himself.

21 Now, sir --

22 MR. WHITNEY: He answered the question  
23 you're fighting with him about. If you go  
24 back and ask the reporter the original

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1 question you asked him about concealing  
 2 information, listen to his answer, he answered  
 3 the question, and then he gave a further  
 4 statement. And you and he are talking about  
 5 that further statement, but the question was  
 6 answered.  
 7 BY MR. ROSENTHAL:  
 8 Q Okay, but do you understand, sir, that  
 9 I'm not asking you a question that relates to the  
 10 further statement? I'm asking you simply about  
 11 whether you uncovered such evidence in the course  
 12 of your review.  
 13 MR. TORBORG: And which evidence is that?  
 14 MR. ROSENTHAL: The prior two questions  
 15 about concealing information, withholding  
 16 information. I just want to understand if the  
 17 witness understands my question.  
 18 MR. TORBORG: Objection, compound.  
 19 A I did not -- first of all, I'm looking  
 20 and I'm trying to retain things that I think are  
 21 significant. If I encounter something that I  
 22 viewed as insignificant or inconsequential, I  
 23 don't try to retain it. So I didn't bring  
 24 anything with me today in my head that struck me

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1 as important, along the lines of your question.  
 2 So I don't have anything in my head that relates  
 3 to that particular question.  
 4 BY MR. ROSENTHAL:  
 5 Q In the four plus years of work done by  
 6 you and your team on this matter, did you note any  
 7 evidence of collusion within the company or with  
 8 third parties with respect to information that was  
 9 not provided to Coopers & Lybrand?  
 10 MR. TORBORG: I object to form.  
 11 A No, I'm of the opinion that Coopers &  
 12 Lybrand had what it needed.  
 13 BY MR. ROSENTHAL:  
 14 Q Again, sir, my question is, did you see  
 15 any evidence of collusion to withhold information?  
 16 MR. TORBORG: Asked and answered.  
 17 A And your last words were not provided to  
 18 Coopers & Lybrand, and I think that Coopers &  
 19 Lybrand was provided with sufficient matters on  
 20 the issues that are in play in this case.  
 21 BY MR. ROSENTHAL:  
 22 Q Given that qualification in your answer,  
 23 is it the case that you saw evidence of collusion  
 24 that didn't matter to Coopers & Lybrand, because

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1 they had sufficient information?  
 2 MR. TORBORG: I object to form.  
 3 A No.  
 4 BY MR. ROSENTHAL:  
 5 Q Did management, in your opinion, AHERF  
 6 management commit intentional fraud?  
 7 MR. TORBORG: I object to form.  
 8 A I haven't been asked to attempt to make  
 9 that determination, and as a result, I don't have  
 10 an opinion with respect to that issue.  
 11 BY MR. ROSENTHAL:  
 12 Q So you don't have an opinion as to  
 13 whether or not management intentionally misstated  
 14 the financial statements?  
 15 A That's not something that I've been asked  
 16 to opine on, and as a result, I haven't focused  
 17 and structured my work to lead me to be able to  
 18 give an opinion in that area and be able to  
 19 provide an appropriate basis for it.  
 20 Q Do you agree, sir, that because the  
 21 characteristics of irregularities, a properly  
 22 designed and executed audit may not detect a  
 23 material irregularity?  
 24 A I recognize that that's a possibility in

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1 an audit.  
 2 Q Do you agree that audit procedures that  
 3 are effective for detecting a misstatement that is  
 4 unintentional may be ineffective for detecting a  
 5 misstatement that is intentional?  
 6 A I can envision facts and circumstances  
 7 where that could occur.  
 8 Q Were there some members of AHERF  
 9 management who were certified public accountants?  
 10 A It's my recollection, yes.  
 11 Q And do certified public accountants have  
 12 obligations, professional obligations beyond those  
 13 of ordinary employees who are not CPAs?  
 14 A I believe so. I think that's been  
 15 discussed in my rebuttal report.  
 16 Q And what are the nature of the additional  
 17 responsibilities, professional responsibilities  
 18 that certified public accountants have, beyond  
 19 those of ordinary employees?  
 20 MR. TORBORG: I object to form.  
 21 A My recollection is that, in my rebuttal  
 22 report, what I commented on was the auditor's  
 23 responsibility. I think Mr. Tillett discussed the  
 24 responsibilities and included that in his report.

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1 If you have a copy of those pages, I'd be happy to  
2 look at them and see to the extent I agree.

3 BY MR. ROSENTHAL:

4 Q Well, we will return to this subject.

5 Do you agree that the auditor's opinion  
6 on the financial statements is based, in the  
7 context of a GAAS audit, is based on the concept  
8 of reasonable assurance?

9 A Yes.

10 Q And do you agree that because the  
11 auditor's opinion on the financial statements is  
12 based on the concept of reasonable assurance, the  
13 auditor is not an insurer of the financial  
14 statements?

15 A I agree with that.

16 Q Do you agree that the auditor is not a  
17 guarantor --

18 A I agree with that.

19 Q -- of the financial statements?

20 A Yes.

21 Q Do you also agree that the subsequent  
22 discovery that a material misstatement exists in  
23 the financial statements for a given period, does  
24 not in and of itself evidence inadequate planning,

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1 performance or judgment on the part of the  
2 auditor?

3 A Yes.

4 Q I'm going to hand you what has previously  
5 been marked as Exhibit 435, there are a few  
6 versions of this floating around. You may have  
7 seen one that has a different number on it.

8 But do you recognize the document that  
9 has been marked as Exhibit 435?

10 A Yes.

11 Q And Exhibit 435 is a document, a letter,  
12 addressed to a Mr. Mike Martin, vice president and  
13 treasurer of AHERF from Barbara K. Robinson, Vice  
14 President of the Mellon Bank, and then it has  
15 handwriting on it. Is that right?

16 A It does, yes.

17 Q Do you know whether the Mellon Bank was  
18 the trustee for a number of trusts that existed on  
19 behalf of AHERF?

20 A I believe it was.

21 Q Now, have you read the letter that is the  
22 underlying document in Exhibit 435?

23 A Yes.

24 Q Does Ms. Gordon set out in Exhibit 435

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1 her view on behalf of Mellon Bank that a number of  
2 the Lockhart trusts are restricted trusts within  
3 the meaning of, she doesn't use the accounting  
4 terms, but her description is such that it  
5 qualifies as restricted within the meaning of  
6 FAS 116 and 117 and 124; is that right?

7 MR. TORBORG: I object to form. I think  
8 you misspoke.

9 THE WITNESS: You said Ms. Gordon.

10 MR. ROSENTHAL: I'm sorry, Ms. Robinson.

11 MR. TORBORG: I have a further objection  
12 to form as well.

13 MR. ROSENTHAL: Well, let me withdraw  
14 that.

15 Q Why don't you read the document and then  
16 I will have some questions.

17 A Okay, I looked at the document.

18 Q Now, you understand, sir, that these  
19 trusts had a principal also known as a corpus, and  
20 generated interest, correct?

21 A Yes.

22 Q And that there was language in the trust  
23 agreements that refer to what counted as income  
24 and what counted as part of the corpus or

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1 principal of the trust, right?

2 A Yes.

3 Q And that one issue with respect to  
4 classification of the trusts on the financial  
5 statements of AHERF, was whether gains from  
6 appreciation and value, or from, at point of sale,  
7 on part of corpus, counted as income or was to be  
8 put back to the corpus? Do you understand that?

9 A I do.

10 Q And does Ms. Robinson express the view on  
11 behalf of Mellon Bank, the trustee of these  
12 trusts, that for most of these trusts, the gains  
13 from any disposition or sale of part of the trust,  
14 the corpus, was to be put back to the corpus?

15 MR. TORBORG: I object to form.

16 BY MR. ROSENTHAL:

17 Q That is, it was not part of income within  
18 the meaning of the trust agreements?

19 MR. TORBORG: I object to form.

20 A Yes, her second paragraph indicates, or  
21 she states that, (Reading) My review indicates a  
22 mixed response. Several of the trusts are quite  
23 explicit, that only income is available.

24





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| <p style="text-align: right;">Page 209</p> <p>1 of entries, journal entries, relating to<br/>2 contractual allowances, you would not expect the<br/>3 auditor to examine each of those journal entries,<br/>4 correct?<br/>5 A No.<br/>6 Q And that approach of selective testing<br/>7 and audit sampling is used in audits and generally<br/>8 accepted as a standard audit approach, is it not?<br/>9 A Yes, you need to do risk assessment, and<br/>10 based upon the risk assessment, you design at<br/>11 first the depth and breadth of audit procedures<br/>12 that are appropriate, given the facts and<br/>13 circumstances and the findings, that are learned<br/>14 by the auditor during the planning process, during<br/>15 its prior relationship with the client, and during<br/>16 the course of the current engagement.<br/>17 It's a constant assessment made by the<br/>18 auditor of risks of misstatement and need for<br/>19 sampling and analysis.<br/>20 MR. ROSENTHAL: I'm told there is five<br/>21 minutes left on the tape, so why don't we<br/>22 switch tapes.<br/>23 THE VIDEOGRAPHER: This marks the end of<br/>24 Tape Number 3 in the deposition of Paul Regan.</p> | <p style="text-align: right;">Page 211</p> <p>1 A I believe I've heard that statement. I<br/>2 don't recall when they received such a letter.<br/>3 Q Well, if you were the auditor of AHERF<br/>4 and you were to subsequently learn after the<br/>5 issuance of the fiscal 1997 audit financial<br/>6 statements, that management had such a letter<br/>7 prior to the issuance of those financial<br/>8 statements, would it upset you, as the auditor,<br/>9 that they had such a letter and hadn't provided it<br/>10 to you?<br/>11 A I certainly would want to know what their<br/>12 bases for not concurring with the letter and<br/>13 acting accordingly, you know, what was the other<br/>14 information which the company or management,<br/>15 certain persons within management relied upon,<br/>16 rather than the letter. And based upon that<br/>17 answer, based upon that answer, that would<br/>18 influence my reaction.<br/>19 Q And you wouldn't be in a position to ask<br/>20 those questions about what did you rely on rather<br/>21 than the letter, if you didn't know about the<br/>22 letter, correct?<br/>23 A That's correct.<br/>24 Q Would you agree that auditors have as</p> |
| <p style="text-align: right;">Page 210</p> <p>1 We are going off the record at 3:27.<br/>2 (Whereupon a recess was taken, after<br/>3 which the following proceedings<br/>4 were held:)<br/>5 THE VIDEOGRAPHER: Here begins Tape<br/>6 Number 4 in the deposition of Paul Regan.<br/>7 We're going back on the record at 3:31.<br/>8 BY MR. ROSENTHAL:<br/>9 Q Mr. Regan, you offer an opinion that<br/>10 AHERF calculated compliance with the Morgan<br/>11 Guarantee Trust, consolidated unrestricted fund<br/>12 balance portion of an indenture agreement between<br/>13 AHERF and Morgan Guarantee Trust, correct?<br/>14 A Yes.<br/>15 Q Have you learned that AHERF management<br/>16 obtained a letter from Foley &amp; Lardner, a law<br/>17 firm, offering its opinion that management had<br/>18 incorrectly calculated the unrestricted fund<br/>19 balance?<br/>20 A I believe I've heard that.<br/>21 Q So you're aware that management had a<br/>22 letter from Foley &amp; Lardner, the conclusion of<br/>23 which was that there was noncompliance with the<br/>24 debt covenant?</p>  | <p style="text-align: right;">Page 212</p> <p>1 their primary concern, not individual<br/>2 transactions, but the financial statements taken<br/>3 as a whole?<br/>4 A As a general rule, yes. But when they're<br/>5 actually doing the audit and they become aware of<br/>6 individual transactions, they can become very<br/>7 concerned about those transactions.<br/>8 Q Does knowledge that an auditor gains in<br/>9 its prior audits accumulate and contribute to<br/>10 their ensuing audits?<br/>11 A Yes.<br/>12 Q Would you agree that not all of that<br/>13 accumulated knowledge needs to be, or even<br/>14 practically, could be documented?<br/>15 MR. WHITNEY: I'll object as compound.<br/>16 A I agree that not all cumulative knowledge<br/>17 can be documented, but significant findings,<br/>18 conclusions, concerns, should be documented.<br/>19 BY MR. ROSENTHAL:<br/>20 Q Would you agree that management possesses<br/>21 a knowledge about its business that is<br/>22 substantially greater than its outside auditors?<br/>23 A I would agree that it is generally the<br/>24 case, that's the expected case. I don't know that</p>   |

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| <p style="text-align: right;">Page 213</p> <p>1 it's always true, but it's the expected case.</p> <p>2 Q Would you agree that management is</p> <p>3 responsible for the performance of the company and</p> <p>4 not its auditors?</p> <p>5 A Generally I agree that that as a general</p> <p>6 statement is correct. There certainly will be</p> <p>7 certain aspects of a company that may be the</p> <p>8 responsibility of the auditors.</p> <p>9 Q Would you agree that management is</p> <p>10 responsible for preparing the company's financial</p> <p>11 statements?</p> <p>12 A Generally, that's the expectation. The</p> <p>13 reality is sometimes the auditor does that.</p> <p>14 Q In the case of AHERF, did management</p> <p>15 prepare the financial statements?</p> <p>16 A That's my expectation, that management</p> <p>17 prepared the financial statements.</p> <p>18 Q Would you agree that the accounting</p> <p>19 estimates that are reflected or incorporated in a</p> <p>20 company's financial statements are management's</p> <p>21 estimates?</p> <p>22 A They should be.</p> <p>23 Q And the auditor's role is limited to</p> <p>24 assessing the reasonableness of management's</p> | <p style="text-align: right;">Page 215</p> <p>1 A (Reading) The concept of materiality</p> <p>2 recognizes that some matters, either individually</p> <p>3 or in the aggregate, are important for a fair</p> <p>4 presentation of financial statements in conformity</p> <p>5 with generally accepted accounting principles.</p> <p>6 Q And then there are three dots. That's an</p> <p>7 ellipses, right?</p> <p>8 A Yes.</p> <p>9 Q That indicates that material has been</p> <p>10 omitted?</p> <p>11 A Correct.</p> <p>12 Q What words were omitted from AU 312.03</p> <p>13 that follow the word "principles"?</p> <p>14 A "While other matters are not important."</p> <p>15 Q Why did you leave those words out from</p> <p>16 your description of the concept of materiality,</p> <p>17 the quote that you have here?</p> <p>18 A The statement that is quoted is that the</p> <p>19 concept of materiality recognizes that some</p> <p>20 matters, either individually or in the aggregate,</p> <p>21 are important. That certainly implies that some</p> <p>22 are not. I think that's kind of, that's really</p> <p>23 not necessary. I wanted to focus on the fact</p> <p>24 that some matters are important individually or</p> |
| <p style="text-align: right;">Page 214</p> <p>1 estimates, is that true?</p> <p>2 MR. WHITNEY: Objection, foundation.</p> <p>3 A That's the way it often works. Sometimes</p> <p>4 in a particular account, a warranty reserve or a</p> <p>5 bad debt reserve, the auditors will make a</p> <p>6 determination and there will be a discussion and</p> <p>7 consultation, and then it might be recorded to the</p> <p>8 amount that's done by the auditor. But generally,</p> <p>9 you expect management to do that. You certainly</p> <p>10 want management to do that.</p> <p>11 BY MR. ROSENTHAL:</p> <p>12 Q Are all accounting entries that violate</p> <p>13 accounting rules material to the financial</p> <p>14 statements taken as a whole?</p> <p>15 A That would not be what my expectation is.</p> <p>16 I would think that there are some that are not.</p> <p>17 Q Would you take a look at page 15 of your</p> <p>18 report, Paragraph 14(A).</p> <p>19 A Page 15, paragraph?</p> <p>20 Q 14(A) -- I'm sorry, not 14, 4.</p> <p>21 A 4(A)?</p> <p>22 Q Yes, 4(A). And specifically, actually,</p> <p>23 subparagraph 2, you have a quote here. Can you</p> <p>24 read that quote for me, please?</p>    | <p style="text-align: right;">Page 216</p> <p>1 in the aggregate.</p> <p>2 What we're here to talk about and address</p> <p>3 in this report are those matters that are</p> <p>4 important. I think that the part quoted implies</p> <p>5 that the other words, and the other words are not</p> <p>6 important. We're not talking about matters that</p> <p>7 are not material.</p> <p>8 Q I'm a bit confused by your answer. I'm</p> <p>9 not sure, are you saying that these words are --</p> <p>10 you omitted the words "while other matters are not</p> <p>11 important," because that's clear and implied from</p> <p>12 what is there? Or are you saying, you omitted</p> <p>13 them because that's a part of the concept that you</p> <p>14 were not trying to address here?</p> <p>15 A I think both. Also, this paragraph goes</p> <p>16 on after that and --</p> <p>17 Q But the sentence ends with those words,</p> <p>18 right?</p> <p>19 A The sentence ends with the words --</p> <p>20 Q "While other matters are" --</p> <p>21 A "while other matters are not important."</p> <p>22 MR. WHITNEY: Let's all talk separately</p> <p>23 here, guys.</p> <p>24 A The sentence ends with the words, "while</p>                   |



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| <p style="text-align: right;">Page 217</p> <p>1 other matters are not important."</p> <p>2 BY MR. ROSENTHAL:</p> <p>3 Q Now, if you look at 4(A)(i), you begin</p> <p>4 that passage with an ellipse. What is left out</p> <p>5 here?</p> <p>6 A There is a prior sentence that says, the</p> <p>7 existence of audit risk is recognized by the</p> <p>8 statement in the auditor's report that the auditor</p> <p>9 obtain reasonable assurance about whether the</p> <p>10 financial statements are free of material</p> <p>11 misstatement.</p> <p>12 Q And why did you leave that statement out</p> <p>13 of Paragraph 4(A)(i)?</p> <p>14 A Because I think that the second sentence</p> <p>15 is the sentence which is particularly important to</p> <p>16 understanding my report and what audit risk is.</p> <p>17 Audit risk is the risk that the auditor</p> <p>18 may unknowingly fail to appropriately modify his</p> <p>19 opinion on the financial statements that are</p> <p>20 materially misstated. That's what I wanted to</p> <p>21 drive home. That's what audit risk is. Her</p> <p>22 sentence doesn't, doesn't really tell that story.</p> <p>23 Q Now, sir, if you will take a look at (v)</p> <p>24 at the top of page 16, you have a quote from</p> | <p style="text-align: right;">Page 219</p> <p>1 got to make judgments as to, well, what are the</p> <p>2 important aspects that you're trying to</p> <p>3 communicate? Because I can't insert this book and</p> <p>4 all the FASs that it relates to. I've got to pick</p> <p>5 those items, which I think are relevant and</p> <p>6 reliable to my opinion.</p> <p>7 Q So that example was not relevant to</p> <p>8 illustrate what that statement from AU 312 was</p> <p>9 describing?</p> <p>10 MR. WHITNEY: Objection, asked and</p> <p>11 answered.</p> <p>12 A I don't think so. I don't think it is</p> <p>13 relevant to the case. I mean, we don't have an</p> <p>14 illegal payment that I'm aware of.</p> <p>15 BY MR. ROSENTHAL:</p> <p>16 Q Precisely.</p> <p>17 Now, on page 7 to 8 of your report, you</p> <p>18 have a listing of the hierarchy of GAAP, generally</p> <p>19 accepted accounting principles; is that right?</p> <p>20 A 7 and 8 is a discussion of generally, the</p> <p>21 nature of generally accepted accounting</p> <p>22 principles, and I described the sources of</p> <p>23 established accounting principles. My reference</p> <p>24 to, in Footnote 10, to SAS-69, which, as we've</p> |
| <p style="text-align: right;">Page 218</p> <p>1 AU 312.07, "As a result of the interaction of</p> <p>2 quantitative and qualitative considerations in</p> <p>3 materiality judgments, misstatements of relatively</p> <p>4 small amounts that come to the auditors' attention</p> <p>5 could have a material effect on the financial</p> <p>6 statements."</p> <p>7 Do you see that?</p> <p>8 A Yes.</p> <p>9 Q Does AU 312.07 continue with a</p> <p>10 one-sentence example of what it means by the</p> <p>11 second sentence that you quoted?</p> <p>12 A Yes.</p> <p>13 Q And what is the example?</p> <p>14 A For example, an illegal payment of an</p> <p>15 otherwise immaterial amount could be material if</p> <p>16 there is a reasonable possibility that it could</p> <p>17 lead to a material contingent liability or a</p> <p>18 material loss of revenue.</p> <p>19 Q Why did you leave that example out of</p> <p>20 your Paragraph 5?</p> <p>21 A I think the first sentence sets the pace,</p> <p>22 sets the standard, this is one example. There is</p> <p>23 lots of examples.</p> <p>24 When you write a report like this, you</p>   | <p style="text-align: right;">Page 220</p> <p>1 discussed previously today, really lays out all of</p> <p>2 the various pieces of GAAP and its hierarchy.</p> <p>3 Q Now, in Item C on page 8, Item C on</p> <p>4 page 8, you say, "For entities such as AHERF and</p> <p>5 its obligated groups which issued municipal</p> <p>6 securities, rules and interpretive releases of the</p> <p>7 SEC have the highest authority similar to Category</p> <p>8 1." Do you see that?</p> <p>9 A I do.</p> <p>10 Q Are staff accounting bulletins</p> <p>11 interpretive releases of the SEC or rules of the</p> <p>12 SEC?</p> <p>13 A Did you finish?</p> <p>14 Q Yes.</p> <p>15 THE WITNESS: Can I hear the question?</p> <p>16 (Question read)</p> <p>17 A I look at them as practices followed by</p> <p>18 the SEC staff in administering SEC disclosures, so</p> <p>19 they don't -- I don't view them as part of</p> <p>20 Category 1.</p> <p>21 BY MR. ROSENTHAL:</p> <p>22 Q Is it possible that a non-professional</p> <p>23 and non-technically informed reader of your</p> <p>24 Paragraph C could get the impression that you</p>   |